DEFERRED COMPENSATION AUTHORIZATION
STATE OF ILLINOIS

NOTE TO EMPLOYEE:
Complete 3 Copies

TO: Office of the Comptroller
201 State House
Springfield, Illinois 62706

I AM PAID: ☐ Monthly ☐ Semi-Monthly ☐ Bi-Weekly

I have requested deferral of my prospective compensation, in the amount shown below, in accordance with the State (of Illinois) Employees' Deferred Compensation Plan.

Deferral for Deferred Compensation Plan Fund

Employee Name _____
LAST FIRST MIDDLE

Street _____ City _____

State _____ Zip _____ Social Security Number _____

Agency _____ Payroll Code No. _____

Amount of Deferral per Pay Period: $ _____

Effective Pay Period _____ Employee Signature _____

Approval of Department of Personnel _____ Date _____

DP DC C-29 (1-79)

ILLINOIS STATE LIBRARY
MAY 29 1979
ILLINOIS DOCUMENTS

ROWE PRICE NEW INCOME FUND, INC.

100 EAST PRATT STREET, BALTIMORE, MARYLAND 21202
Toll Free Telephone: 1-800-638-1527; Call Collect in Area 301: 547-2000

A NO-LOAD FUND	INVESTMENT MINIMUMS
Shares are Purchased and Redeemed At Net Asset Value **NO SALES CHARGE**	Initial Investment: $1,000 Subsequent Investments: $ 100
INVESTMENT OBJECTIVE	**INVESTMENT ADVISER**
The objective of the Fund is to achieve the highest income over the long term consistent with preservation of principal. The Fund seeks to achieve its objective through investment primarily in marketable debt securities. There can be no assurance that the Fund will achieve its objective.	The Fund's investment adviser is T. Rowe Price Associates, Inc. ("Price Associates"), which receives an annual fee of ½ of 1% of the first $100,000,000 of the average daily net assets of the Fund, 45/100 of 1% of the next $100,000,000 of such assets and 4/10 of 1% of such assets over $200,000,000. (See page 6.)

THE FUND

Rowe Price New Income Fund, Inc. is a Maryland corporation organized in 1973. It is one of six no-load mutual funds for which Price Associates serves as investment adviser. (See page 8.)

It should be understood that the Fund is not a "money market" fund since its investments may include intermediate and long-term debt securities, as well as short-term money market instruments.

The market values of fixed-income securities usually vary depending upon available yields; consequently, the net asset value of the Fund will change as interest rates fluctuate.

At times the Fund may concentrate up to 50% of its assets in the securities of issuers in the gas utility, gas transmission utility, electric utility, telephone utility, or petroleum industry. (See page 5.)

NO-LOAD–NO SALES CHARGE

Shares of the Fund are offered and redeemed at net asset value per share. In this respect, the Fund and other no-load funds differ from many mutual funds whose shares are sold at prices which incorporate sales charges. Since nothing is deducted for sales commissions, the entire investment in the Fund is applied to the purchase of shares.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION, NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

Shareholders should retain this booklet for future reference.

Prospectus May 1, 1978

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INVESTMENT PROGRAM

The policy of the Fund is to conduct its activities so that after any purchase at least 75% of the value of its total assets (exclusive of cash) will be invested in one or more of the following types of interest-bearing obligations: (1) marketable straight debt securities rated at the time of purchase within the four highest grades assigned by Moody's Investors Service, Inc. ("Moody's"), (Aaa, Aa, A, or Baa) or by Standard & Poor's Corporation ("Standard & Poor's"), (AAA, AA, A, or BBB)*; (2) securities issued or guaranteed by the U.S. Government or its agencies or instrumentalities; (3) marketable securities (payable in U.S. dollars) issued or guaranteed by the Government of Canada, any Province of Canada, or any instrumentality or political subdivision thereof; (4) bank obligations having investment quality, in the opinion of management, comparable with debt securities which may be purchased by the Fund as described in (1) above; and (5) commercial paper.

* As of March 31, 1978, 64.2% of the Fund's total assets were invested in securities rated by Moody's or Standard & Poor's, 9.9% rated AAA or Aaa, 19.6% rated AA or Aa, 26.2% rated A, 5.8% rated BBB or Baa, and 2.7% rated A-1 or P-1. Securities rated Baa and BBB are in the lowest grade which qualifies for investment by commercial banks. They are considered medium-grade obligations and are relatively more susceptible to changing economic conditions than higher quality securities. For a complete description of Moody's and Standard & Poor's ratings, see page 19. It should be understood that 33.5% of the Fund's total assets were invested in securities that were not rated by either Moody's or Standard & Poor's. 2.7% of the Fund's total assets were invested in Federal agencies, 28.2% in certificates of deposit, and 2.6% in bankers' acceptances, which are not rated by these rating agencies, but which are considered to be very high quality debt securities.

Numerous investment companies, having different investment objectives and techniques and involving varying degrees of risk, continuously offer their shares to investors.

For the fiscal year ended December 31, 1977, the Fund's total operating expenses, including advisory fees, were approximately 0.58% of average total net assets.

Up to 25% of the value of the Fund's total assets (exclusive of cash) may consist of other debt securities (including securities convertible into, or carrying warrants to purchase common stock or other equity interests) and preferred and common stocks, provided that at least 80% of the value of the Fund's total assets is maintained in income-producing securities. At no time will the Fund invest more than 10% of the value of its total assets in securities that are not readily marketable. The Fund reserves the right to hold cash reserves as management deems necessary for defensive or emergency purposes.

Although the ratings of Moody's and Standard & Poor's are used as the preliminary criteria of investment quality of marketable straight debt securities, management places primary significance on its own in-depth credit analysis and security research. All of the Fund's investments are selected from an approved list of securities deemed appropriate for the Fund by Price Associates, which maintains a credit rating system based upon comparative credit analyses of issuers within the same industry and individual credit analysis of each company. These analyses take into consideration such factors as a corporation's liquidity, profitability, internal generation of funds, and capital adequacy.

At times when the market for corporate debt securities is dominated by issues in the gas utility, gas transmission utility, electric utility, telephone utility, or petroleum industry, the Fund will concentrate 25% or more, but not more than 50%, of its assets in any one such industry if the Fund has cash for such investment, and in the judgment of management, the return available from such industry, and the marketability, quality, and availability of the debt securities of such industry, justify such concentration in light of the Fund's investment objective. Such domination would be considered to exist when in the preceding 30-day period more than 25% of all new-issue offerings of corporate debt securities within the four highest grades assigned by Moody's, or by Standard & Poor's, in amounts of $25,000,000 or more, consisted of such issues. Investors should understand that concentration in any industry may result in increased risk. It is possible that the public service commissions which have jurisdiction over these industries may not grant future increases in rates sufficient to offset increases in operating expenses. Investments in the gas utility, gas transmission utility, electric utility, telephone utility, and petroleum industries may be affected by environmental conditions, energy conservation programs, fuel shortages, difficulty in obtaining adequate return on capital, in financing operations and large construction programs, and the ability of the capital markets to absorb debt issues. In addition to these potential problems, these industries face numerous legislative and regulatory uncertainties at both Federal and state government levels. Management believes that any risk to the Fund which might result from concentration in any industry will be minimized by the Fund's practice of diversifying its investments in other respects.

Repurchase Agreements

A repurchase agreement is an instrument through which an investor (e.g., the Fund) purchases a security from a bank that is a member of the Federal Reserve System, with an agreement by the seller to repurchase the security at the same price, plus interest at a specified rate. The underlying securities are limited to those described above. Repurchase agreements usually have a short duration, often less than one week. The Fund will not enter into a repurchase agreement of a duration of more than seven business days if, as a result, more than 10% of the value of the Fund's total assets would be so invested.

Portfolio Turnover

The Fund does not intend to purchase securities for short-term trading; however, a security may be sold in anticipation of a market decline (a rise in interest rates), or purchased in anticipation of a market rise (a decline in interest rates), and later sold. Securities will be purchased and sold in response to the Fund's evaluation of an issuer's ability to meet its debt obligations in the future. A security may be sold and another purchased when, in the opinion of the Fund's management, a favorable yield spread exists between specific issues or different market sectors.

The Fund's portfolio turnover rates in the years 1977, 1976, and 1975 were 29.6%, 17.5%, and 37.2%, respectively.

Loans of Portfolio Securities

The Fund may lend its portfolio securities to member firms of the New York Stock Exchange. Any such loans would be continuously secured by collateral in cash, or cash equivalents maintained on a current basis in an amount at least equal to the market value of the securities loaned. (Under current regulatory interpretations, a maximum of 15% of the collateral may be in the form of U.S. Treasury Bills, and the remaining collateral must be in cash.) During the existence of a loan, the Fund would continue to receive the equivalent of the interest or dividends paid by the issuer on the securities loaned and would also receive the interest on investment of the collateral. The Fund would have the right to call a loan and obtain the securities loaned at any time on five days' notice. The Fund would not have the right to vote the securities during the existence of a loan, but would call the loan in anticipation of an important vote to be taken among holders of the securities, or of the giving or withholding of consent on a material matter affecting the investment.

PER SHARE INCOME AND CAPITAL CHANGES

Selected data for each share of capital stock outstanding throughout each period:

	Year Ended December 31,				Aug. 14 (Date of Incorporation) to Dec. 31,
	1977	1976	1975	1974	1973
Investment income	$.82	$.86	$.84	$.87	$.11
Expenses	.06	.07	.07	.08	.02*
Net investment income	.76	.79	.77	.79	.09
Dividends from net investment income	(.77)	(.78)	(.79)	(.66)	None
Net realized and unrealized gains (losses)	(.21)	.56	.29	(.71)	(.12)
Net increase (decrease) in net asset value	(.22)	.57	.27	(.58)	(.03)
Net asset value:					
Beginning of period	$10.23	$ 9.66	$ 9.39	$ 9.97	$10.00
End of period	$10.01	$10.23	$ 9.66	$ 9.39	$ 9.97
Ratio of expenses to average net assets	0.58%	0.68%	0.77%	0.91%	0.51%*
Ratio of net investment income to average net assets	7.61%	8.01%	8.20%	8.64%	1.92%
Portfolio turnover	29.6%	17.5%	37.2%	130.0%	2.8%
Number of shares outstanding at end of period (in thousands)	28,344	20,674	11,800	5,295	924

* In 1973, the expenses would have been $.05 and the expense ratio would have been 1.24%, except for waivers by the Fund's investment adviser and its "non-interested" directors of certain expenses incurred by the Fund.

As of the date of this Prospectus, the Fund had made no loans of its portfolio securities. If in the future any loans are made, the value of the securities loaned would not exceed 15% of the value of the Fund's total assets, and the payments received on such loans, including interest and dividends on the securities received during the existence of a loan, would not exceed in the aggregate 10% of the Fund's annual gross income (without offset for realized capital gains).

INVESTMENT RESTRICTIONS

The Fund may not purchase a security if, as a result: (a) more than 5% of the value of the Fund's total assets would be invested in the securities of a single issuer, except securities issued or guaranteed by the U.S. Government or any of its agencies or instrumentalities; (b) 10% or more of either the outstanding securities of any class or the combined voting power of all classes for the election of directors or otherwise of any issuer would be held by the Fund; (c) 25% or more of the value of the Fund's total assets would be invested in the securities of issuers in a single industry, except that up to 50% of the Fund's assets will be invested in any one of the gas utility, gas transmission utility, electric utility, telephone utility, and petroleum industries under certain circumstances (see page 3), but this limitation does not apply to bank certificates of deposit; (d) more than 5% of the value of the Fund's total assets would be invested in the securities (taken at cost) of issuers which at the time of purchase had been in operation less than three years (for this purpose, the period of operation of any issuer shall include the period of operation of any predecessor or unconditional guarantor of the issuer) and in equity securities which are not readily marketable for reasons other than restrictions against sale to the public without registration under the Securities Act of 1933; (e) unless the security is acquired pursuant to a plan of reorganization or a Securities and Exchange Commission ("SEC") approved offer of exchange, the Fund would own any securities of an open-end investment company or more than 3% of the total outstanding voting stock of any closed-end investment company, or more than 5% of the value of the Fund's total assets would be invested in securities of any closed-end investment company or more than 10% of such value in closed-end investment companies in general; (f) more than 10% of the value of the total assets of the Fund would be invested in securities which are subject to legal or contractual restrictions on resale (as of the date of this Prospectus, the Fund had purchased no such restricted securities); or (g) more than 2% of the value of the total assets of the Fund would be invested in warrants which are not listed on the New York Stock Exchange or the American Stock Exchange, or more than 5% of the value of the total assets of the Fund would be invested in warrants whether or not so listed, such warrants in each case to be valued at the lesser of cost or market, but assigning no value to warrants acquired by the Fund in units with or attached to debt securities.

Also, the Fund may not: (1) purchase or sell real estate (although it may purchase securities of companies whose business involves the purchase or sale of real estate); (2) purchase or sell commodities or commodity contracts; (3) purchase securities on margin or effect short sales of securities; (4) make loans (although it may acquire publicly-distributed bonds, debentures, notes and other debt securities, may buy securities with an agreement by the vendor to repurchase them ("repurchase agreements"), may lend portfolio securities, and may purchase debt securities at private placement within the limits imposed above on the acquisition of restricted securities); (5) borrow money, except for temporary administrative purposes and then only in amounts not exceeding the

lesser of 10% of its total assets valued at cost, or 5% of its total assets valued at market and, in any event, only if immediately thereafter there is an asset coverage of at least 300%; (6) mortgage, pledge, or hypothecate securities, except in connection with permissible borrowings where the market value of the securities mortgaged, pledged, or hypothecated does not exceed 15% of the Fund's assets taken at cost; provided, however, that as a matter of operating policy, the Fund will limit any such mortgaging, pledging, or hypothecating to 10% of its net assets, taken at market, in order to comply with certain state investment restrictions; (7) act as an underwriter of securities, except insofar as it might be deemed to be such for purposes of the Securities Act of 1933 upon the disposition of certain portfolio securities acquired within the limitations of restriction (f) above; (8) purchase or retain the securities of any issuer if, to the knowledge of the Fund's management, those officers or directors of the Fund, or of its investment adviser, who each owns beneficially more than ½ of 1% of the outstanding securities of such issuer, together own beneficially more than 5% of such securities; (9) invest in companies for the purpose of exercising management or control; (10) invest in puts, calls, straddles, spreads, or any combination thereof; or (11) invest in the securities of closed-end investment companies, except by purchase in the open market involving only customary brokerage commissions or as part of a plan of merger, consolidation, or acquisition of assets.

All of these investment restrictions, except that described as an operating policy in (6), are fundamental policies and may not be changed without the approval of at least a majority of the outstanding shares of the Fund or, if it is less, 67% of the shares represented at a meeting of shareholders at which the holders of 50% or more of the shares are represented. In addition, as a matter of operating policy, the Fund does not purchase participations or other direct interests in oil, gas or other mineral exploration, or development programs. Operating policies are subject to change by the Board of Directors without shareholder approval.

INVESTMENT ADVISER

The Fund's investment adviser is Price Associates, a Maryland corporation, which serves as investment adviser to individual and institutional investors. E. Kirkbride Miller is the chief executive officer, and certain officers and directors of the Fund are also officers, directors, and/or employees, of Price Associates. (See "Officers and Directors", page 8.) As of December 31, 1977, E. Kirkbride Miller, Donald E. Bowman, Hal B. Howard, Cornelius C. Bond, Jr., and Curran W. Harvey, together with certain members of their respective families, were the beneficial owners of 18.0%, 10.7%, 8.3%, 7.3%, and 5.0%, respectively, of the outstanding stock of Price Associates. Such amounts include the interests of such individuals in the T. Rowe Price Associates, Inc. Employee Stock Ownership Trust, which as of that date owned of record 13.3% of such stock.

Price Associates serves as investment adviser to the Fund pursuant to an Investment Advisory Agreement dated May 1, 1976, which continues in effect from year to year if such continuation is specifically approved at least annually by the Board of Directors of the Fund at a meeting called for that purpose, or by vote of a majority of the outstanding shares of the Fund and, in either case, by vote of a majority of the directors of the Fund who are not "interested persons" (as defined in the Investment Company Act of 1940) of Price Associates or the Fund. On February 21, 1978, the directors of the Fund, including a majority of the directors who are not "interested persons" of Price Associates or the Fund, voted to extend the Agreement for a period of one year through

April 30, 1979. The Agreement is subject to termination by either party without penalty on 60 days' written notice to the other, and will terminate automatically in the event of assignment.

Price Associates provides the Fund with investment supervisory and certain other services. Specifically, Price Associates obtains and evaluates information relating to the economy, industries, businesses, securities markets, and securities; furnishes a program for the management of the Fund's assets; makes recommendations regarding securities to be purchased and sold by the Fund; pays all executive salaries, executive expenses, and office rent of the Fund; furnishes the Fund office space, equipment and personnel, utilities, and other necessary office services; monitors the Fund's financial controls; coordinates the activities of agents employed by the Fund; and pays all Fund sales and promotional expenses (which do not include expenses incurred in complying with laws regulating the issue or sale of securities).

The Fund's Board of Directors has requested Price Associates to perform certain services on behalf of the Fund which are not required by the Agreement; namely, the functions of billing, accounting, and shareholder service, to the extent such services are not performed by the Fund's custodian or transfer agent, and registration of the Fund, and its securities, with the SEC and under state securities laws. The costs of Price Associates in rendering such services may be billed monthly to the Fund, subject to examination by the Fund's independent accountants. Since the inception of the Fund, Price Associates has waived its right to bill the Fund for such expenses. Price Associates has agreed that it will not bill the Fund for such expenses without giving prior notice to the Fund's Board of Directors.

The Agreement provides that neither Price Associates, its directors, officers, or employees, nor certain other persons performing specific functions for the Fund, shall be liable to the Fund, except for loss resulting from willful misfeasance, bad faith, gross negligence, or reckless disregard of duty.

The Agreement provides that the Fund shall bear all expenses of its operations not specifically assumed by Price Associates. However, Price Associates shall reimburse the Fund for expenses (exclusive of interest, taxes, and extraordinary expenses) which in any year exceed 1½% of the first $30,000,000 of the Fund's average daily net assets, and 1% of all such assets in excess of that amount. Certain states require that reimbursement be made for any such expenses which exceed 25% of the Fund's total investment income. Subject to certain regulations promulgated by various states, Price Associates may be precluded from excluding for this purpose extraordinary expenses or certain expenses which may be classified as such. To determine whether reimbursement is due to the Fund, the expenses of the Fund are calculated on a monthly basis. Payment of the advisory fee will be reduced or postponed, if necessary, with any adjustment made after the end of the year. In 1977, the ratio of operating expenses to average net assets of the Fund was 0.58%.

Price Associates is paid an annual fee, in monthly installments, based on the average daily net assets of the Fund, as follows: ½ of 1% of the first $100,000,000 of such assets; 45/100 of 1% of the next $100,000,000 of such assets; and 4/10 of 1% of such assets over $200,000,000. The management fees paid by the Fund for the years 1977, 1976, and 1975 were $1,158,773, $773,082, and $421,445, respectively.

Price Associates may, from time to time, make recommendations which result in the purchase or sale of a particular security by private clients, or by one or more of the other Price funds,

simultaneously with the Fund. If transactions on behalf of more than one client during the same period increase the demand for securities being purchased or the supply of securities being sold, there may be an adverse effect on price. It is the policy of Price Associates not to favor any one client over another in making advisory recommendations or in placing orders for portfolio transactions over a period of time.

Other Price Funds

T. Rowe Price Growth Stock Fund, Inc., seeking long-term growth of capital and increase of future income; investing primarily in well-established growth companies.

Rowe Price New Horizons Fund, Inc., seeking long-term growth of capital; investing primarily in small growth companies.

Rowe Price New Era Fund, Inc., seeking long-term growth of capital; investing primarily in companies which own or develop natural resources and other selected companies.

Rowe Price Prime Reserve Fund, Inc., seeking preservation of capital, liquidity, and the highest possible current income consistent with these objectives which is available primarily through investment in prime money market instruments.

Rowe Price Tax-Free Income Fund, Inc., seeking income exempt from Federal income taxes; investing primarily in municipal securities.

A prospectus for any of the Price funds is available upon request to 100 East Pratt Street, Baltimore, Maryland 21202, or telephone toll free 1-800-638-1527, in Area 301: 547-2000.

OFFICERS AND DIRECTORS

The officers and directors of the Fund, and the number of shares of the Fund beneficially owned by each director as of December 31, 1977, are listed below. Unless otherwise noted, the address of each is 100 East Pratt Street, Baltimore, Maryland 21202; except as indicated, each has been an employee of Price Associates for more than five years. Certain of these individuals are also officers or directors, or both, of one or more of the other Price funds.

CARTER O. HOFFMAN, *President and Director*—Vice President and Director of Price Associates; Chartered Investment Counselor; Shares beneficially owned: 6,418 †‡

DONALD E. BOWMAN, *Director*—Vice Chairman of the Board and Director of Price Associates; Member, U.S. Department of Labor Advisory Council on Employee Welfare and Pension Benefit Plans; Member of Board of Governors, Investment Counsel Association of America, Inc.; Chartered Investment Counselor; Shares beneficially owned: 3,100 †

W. ERNEST ISSEL, *Director*—Retired; Formerly (until 1975) Executive Vice President and Director, McCormick & Company, Inc., international food processors; Director, Mercantile-Safe Deposit & Trust Company; Address: 4300 North Charles Street, Baltimore, Maryland 21218; Shares beneficially owned: 1,053

*LAWRENCE P. NAYLOR, III, *Director*—Chairman, Director, and Treasurer, Catalyst Recovery, Inc., catalyst regeneration for oil refining and petrochemical industries; Senior Vice President (until 1975), Treasurer (until 1975), and Director, The Rouse Company, mortgage bankers and real estate developers; Director, Arlington Federal Savings & Loan Association; Address: 2 Village Square, Baltimore, Maryland 21210; Shares beneficially owned: 1,662

CHARLES W. SHAEFFER, *Director*—Retired; Formerly Chairman of the Board (1966-1975), President (1963-1974), and Director (1947-1976) of Price Associates; Honorary Member of Board of Governors, Investment Counsel Association of America, Inc.; Member of Board of Governors, Investment Company Institute; Address: 14 Midvale Road, Baltimore, Maryland 21210; Shares beneficially owned: –0–

GEORGE J. COLLINS, *Executive Vice President*—Vice President of Price Associates; Chartered Investment Counselor

HOWARD P. COLHOUN, *Vice President*—Vice President of Price Associates; Chairman of the Board of Trustees, Financial Analysts Federation Investment Management Workshop, Dartmouth College; Member, Baltimore County Revenue Commission; Chartered Financial Analyst

CHARLES H. SALISBURY, JR., *Vice President*—Vice President of Price Associates; Chartered Investment Counselor

ALAN M. SCHREIBER, *Vice President*—Vice President of Price Associates

EDWARD A. TABER, III, *Vice President*—Vice President of Price Associates

WILLIAM B. THOMPSON, *Vice President*—Vice President and Director of Price Associates; Member of Board of Governors, No-Load Mutual Fund Association; Chartered Investment Counselor

LENORA V. HORNUNG, *Secretary*—Assistant Vice President of Price Associates

RAYMOND L. SCOTT, *Treasurer*—Vice President of Price Associates

NANCY R. BLYLER, *Assistant Vice Pesident*—Vice President of Price Associates

JOSEPH T. CHADWICK, JR., *Assistant Vice President*—Vice President of Price Associates

JAMES B. COOKE, *Assistant Vice President*—Vice President of Price Associates

CAROLYNN KENDALL, *Assistant Vice President*—Assistant Vice President of Price Associates

CHARLES P. SMITH, *Assistant Vice President*—Vice President of Price Associates

RICHARD S. SWINGLE, *Assistant Vice President*—Assistant Vice President of Price Associates; Vice President of Sales in Corporate Bond Department, Smith Barney, Harris Upham (6/71-8/76)

WILLIAM G. TAYMAN, *Assistant Vice President*—Assistant Vice President of Price Associates

MICHAEL E. ZAHNER, *Assistant Treasurer*—Assistant Vice President of Price Associates

* Representative of the Fund on the Joint Audit Committee of the Price funds, which is comprised of at least one "non-interested" director representing each of the six funds.

† In addition to the shares owned beneficially and of record by each of the directors, the amounts shown reflect the proportionate interests of Messrs. Bowman and Hoffman in 8,475 shares of the Fund owned by Price Associates. Such amounts also include the interests of Messrs. Bowman and Hoffman in shares owned by the T. Rowe Price Associates, Inc. Profit Sharing Trust, but do not reflect the interests of such individuals in 100,658 shares owned by the T. Rowe Price Associates, Inc. Retirement Plan Trust.

‡ The shares beneficially owned by Mr. Hoffman include 500 shares owned by a member of his family, as to which shares he may not be a beneficial owner.

Messrs. Collins, Hoffman, Salisbury, Schreiber, Taber, Smith, and Swingle are the members of Price Associates' Investment Advisory Committee to the Fund.

The Fund's Executive Committee, comprised of Messrs. Bowman and Hoffman, has been authorized by the Board of Directors to assume all of the powers of the Board to manage the Fund in the intervals between meetings of the Board, except the powers prohibited by statute from being delegated.

With the exception of Messrs. Issel and Naylor, the "non-interested" directors of the Fund, all of the officers and directors of the Fund are employees and/or stockholders of Price Associates

and, therefore, are considered to be "interested persons" of the Fund, as defined in the Investment Company Act of 1940.

The directors of the Fund who are, or have been, officers, directors, or employees of Price Associates receive no remuneration from the Fund. For the year ended December 31, 1977, the Fund paid directors' fees aggregating $10,000 to Messrs. Issel and Naylor. Effective January 1, 1978, the directors' fees have been increased to $7,500 per director.

HOW TO PURCHASE SHARES

Initial Investments—Minimum $1,000

By Mail: Send to the Fund in Baltimore a check payable to Price New Income Fund, along with a completed New Account Order Form.

By Telephone: Telephone the Fund in Baltimore (toll free at 1-800-638-1527, or collect in Area 301: 547-2000).

If full payment does not accompany the order, it must be received by State Street Bank and Trust Company (the "Bank") no later than seven days following the trade date. **If payment is not received within the time required, the order is subject to cancellation and purchasers will be responsible for any loss incurred by the Fund.** (See "Payment and Terms of Offering", page 11.)

Subsequent Investments—Minimum $100

Send to the Bank a check payable to Rowe Price New Income Fund, accompanied by either: (a) the detachable form which accompanies the Bank's confirmation of a prior transaction, (b) a subsequent order form which may be obtained from the Fund, or (c) a letter indicating the dollar value of the shares to be purchased and identifying the Fund, the account number, and registration.

Shareholders may also make subsequent investments by mail or by telephone through the offices of the Fund.

Purchase Price

Shares will be priced at the net asset value per share next determined after receipt of the purchase order, accompanied by the required remittance in the case of those orders directed to the Bank. The net asset value per share is computed as of the close of trading on the New York Stock Exchange on each day the Exchange is open for trading, by dividing the value of the Fund's total assets, less its liabilities, by the number of shares then outstanding.

Securities listed or dealt in on a national securities exchange and not subject to restrictions against sale by the Fund on such exchange are valued at the last quoted sales prices on such exchange on the day the valuations are made, unless the Board of Directors, or persons delegated by the Board, determine that over-the-counter quotations more closely reflect the fair market value of the particular security. With respect to securities listed on the New York Stock Exchange, quotations on an exchange, other than that Exchange, may also be used if the Board, or its delegates, determine that such quotations reflect more closely the fair value of the particular security. Listed securities that are not traded on a particular day and securities regularly traded in the over-the-counter market are valued at the price within the limits of the latest bid and asked prices deemed

by the Board, or its delegates, best to reflect a fair value. Other assets and securities are valued in a manner determined in good faith by the Board, or its delegates, to reflect their fair value.

The Board of Directors may, by resolution, authorize adjustments to be made in applying any market quotation in order to reflect the size of the Fund's holding of the particular security, the relation to such size of the volume of trading on which such market quotation is based, and other factors.

The Open Account

By investing in the Fund, a shareholder appoints the Bank, as his agent, to establish an open account to which all shares purchased will be credited, together with any dividends and capital gain distributions which are paid in additional shares. (See "Distributions and Taxes", page 15.) Stock certificates will be issued for full shares when requested in writing. Unless payment for shares is made by certified or cashier's check or federal funds wire, certificates will not be issued for 30 days. In order to facilitate redemptions and transfers, most shareholders elect not to receive certificates.

Payment and Terms of Offering

Payment for shares can be made by federal funds wire, check, or money order drawn on a U.S. bank. Checks drawn on foreign banks will not be accepted unless provision is made for payment through a U.S. bank in U.S. dollars.

As a condition of this offering, if an order to purchase shares is cancelled due to non-payment, the purchaser will be responsible for any loss incurred by the Fund by reason of such cancellation and, if the purchaser is a shareholder, the Fund shall have authority as agent of the shareholder to redeem shares in the account to reimburse the Fund for the loss incurred. Investors whose orders have been cancelled may be prohibited from or restricted in placing future orders in any of the Price funds.

The Fund reserves the right to reject any order, and to waive or lower the investment minimums with respect to any person or class of persons, including shareholders of the Fund's special investment programs. An order to purchase shares is not binding on the Fund until it has been confirmed by the Bank and payment has been received.

Account Statements

The Bank will send shareholders either purchasing or redeeming shares of the Fund a confirmation of the transaction indicating the date the purchase or redemption was accepted, the number of shares purchased or redeemed, the purchase or redemption price per share, the total purchase price or redemption proceeds, and if an unpaid purchase, the date payment is due. A statement is also sent to shareholders whenever an income dividend or capital gain distribution is paid, or when a change in the registration, address, or dividend option occurs. **Shareholders are urged to retain their account statements for tax purposes.**

HOW TO REDEEM SHARES

By Telephone or Telegram. Shares may be redeemed by telephone (Call the Bank toll free: 1-800-225-5132) or telegram (Telex 94-0301 Answerback Sharebank Qncy). The telegram should

include the name of the Fund, account number, registration, and number of shares or dollar amount to be redeemed. **A redemption authorization form must be on file with the Bank before a shareholder may redeem in this manner.** Shareholders may elect on the redemption authorization form to have checks for redemption proceeds mailed either to the registered address, to the shareholder's bank account, or to any other designated person, and a new form must be completed whenever these instructions are revised.

By Check. Shareholders may effect redemptions by writing checks drawn on State Street Bank and Trust Company, payable to the order of any person in any amount of $500 or more. The special forms and instructions may be obtained from the Fund or the Bank.

By Mail. Send to the Bank: (1) a written request for redemption, signed by each registered owner exactly as the shares are registered; (2) stock certificates for any shares to be redeemed which are held by the shareholder; (3) signature guarantees, when required; and (4) the additional documents required for redemptions by corporations, executors, administators, trustees, and guardians. **Redemptions by mail will not become effective until all documents in the form required have been received by the Bank. If a shareholder has any questions regarding the requirements for redeeming shares, he should call the Bank at the toll free number on the back cover prior to submitting a redemption request.** If a redemption request is sent to the Fund in Baltimore, it will be forwarded to the Bank and the effective date of redemption will be the date received by the Bank.

Checks for redemption proceeds will normally be mailed within seven days, but will not be mailed until all checks in payment for the shares to be redeemed have been cleared. Shareholders may request that redemption proceeds of $500 or more be wired directly to a bank account. The signatures on such a request must be guaranteed, unless an authorization for redemption by telephone or telegram form has been previously filed with the Bank. The Bank presently deducts a $2.50 wire charge from the proceeds of the redemption.

Procedures for redemptions by telephone, telegram, or check may only be used for shares for which stock certificates have not been issued, and may not be used to redeem shares purchased by personal check which have been on the books of the Fund for less than 30 days.

Signature Guarantee

Signature guarantees are required in connection with (a) redemptions by mail involving $5,000 or more on the date of receipt by the Bank of all necessary documents; (b) all redemptions by mail, regardless of the amount involved, when the proceeds are to be paid to someone other than the registered owner(s); (c) authorizations to effect redemptions by telephone, telegram, or check; (d) changes in instructions as to where the proceeds of redemptions are to be sent; and (e) share transfer requests. These requirements may be waived by the Fund in certain instances.

The Bank requires that the guarantor be either a commercial bank which is a member of the Federal Deposit Insurance Corporation, a trust company, a member firm of a domestic stock exchange, or a foreign branch of any of the foregoing. **Notary publics, savings and loan associations, and savings banks are unacceptable guarantors.**

With respect to redemption requests submitted by mail, the signature guarantees must appear either: (a) on the written request for redemption, (b) on a separate instrument of assignment ("stock power") which should specify the total number of shares to be redeemed, or (c) on all stock certificates tendered for redemption and, if shares held by the Bank are also being redeemed, on the letter or stock power. Signature guarantees in connection with redemptions by telephone, telegram, or check must appear on the appropriate authorization form.

Redemption Price

The redemption price will be the net asset value per share of the Fund next determined after receipt by the Bank of a redemption request in proper form. (See "Purchase Price", page 10.) The Fund has the right to reduce the amount received by the shareholder by up to 1% of the net asset value, but it would do so only after notice to shareholders and then only on shares surrendered for redemption within six months of purchase, as a last recourse to prevent short-term trading in the Fund by speculators. Management has never assessed such a charge, and has no present intention of doing so.

The right of redemption may be suspended (a) for any period during which the New York Stock Exchange is closed or the SEC determines that trading on the Exchange is restricted, (b) when there is an emergency as determined by the SEC as a result of which it is not reasonably practicable for the Fund to dispose of securities owned by it or to determine fairly the value of its net assets, or (c) for such other period as the SEC may by order permit for the protection of shareholders of the Fund.

HOW TO TRANSFER SHARES

Send to the Bank at P.O. Box 2357, Boston, Massachusetts 02107, a written request for the transfer of shares to another owner (1) providing the new registration, social security number, and distribution option, (2) signed by the registered owner(s) exactly as the account is registered, (3) enclosing any stock certificates which are held by the shareholder for shares to be transferred, (4) signature guarantees (see "Signature Guarantee", page 12), and (5) any additional documents which may be required for transfers by corporations, executors, trustees, and guardians. **If a shareholder has any questions regarding the requirements for a transfer, he should call the Bank at the toll free number on the back cover before submitting the request.**

SHAREHOLDER SERVICES

Special applications and additional information about any of the Fund's special plans may be obtained from the Fund or the Bank.

Exchange—Shares of the Fund may be exchanged for shares of any other Price fund (see page 8) by telephone or telegram (if authorized in advance), or by mail. A prospectus of the other fund should be read in advance. Purchases are subject to the initial minimum investment for that fund, and the shares exchanged by telephone or telegram must be held by the Bank. For tax purposes, such a transaction is treated as a redemption and purchase of shares. A signature guarantee is required on the authorization form to exchange by telephone or telegram, for exchanges by mail in

excess of $5,000, or if the exchange is being made into an account whose registration is not identical to that of the account being redeemed.

Transfer—Shares of the Fund may be transferred to another owner. A signature guarantee is required on the letter of instruction or accompanying stock power. (See "How to Transfer Shares", page 13.)

Systematic Investing—Reminders to make regularly scheduled investments will be sent to shareholders upon request, with no obligation to invest at any time.

Check Deposit—Regular investments can be automatically deducted from the shareholder's checking account. The minimum investment is $50.

Cash Withdrawal—Shareholders may elect to withdraw cash in fixed or variable amounts from their accounts at regular intervals. The minimum investment to establish a Cash Withdrawal Plan is $10,000. If the proceeds are to be mailed to someone other than the registered owner, a signature guarantee is required.

Group Sub-Accounting—To minimize recordkeeping by fiduciaries, corporations, and certain other investors. The minimum initial investment may be waived.

Automatic Deposit of Social Security Checks—Social Security checks can now be automatically deposited to purchase mutual fund shares.

Redemption by Check—Shareholders may effect redemptions by writing checks drawn on the Bank. (See "Redemption By Check", page 12.) A signature guarantee is required on the Redemption By Check Form.

Redemption by Telephone or Telegram—See "How to Redeem Shares", page 11. A signature guarantee is required on the application.

Tax-Sheltered Retirement Plans

Self-Employed Retirement Plan (Keogh)—Self-employed individuals may make tax-deductible contributions to a prototype retirement plan which conforms to the provisions of the Self-Employed Individuals Tax Retirement Act of 1962 (Keogh Act). Under the Plan, an eligible individual may invest up to 15% of annual earned income from self-employment, or $7,500, whichever is less.

Individual Retirement Account (IRA)—Individuals who have not participated during the year in an employer-sponsored retirement plan may make tax-deductible contributions to their own Individual Retirement Accounts established under Section 408 of the Internal Revenue Code. Under the Plan, an eligible individual may invest up to 15% of annual earnings, or $1,500, whichever is less. However, if you are eligible and have an unemployed spouse, you may be able to invest a total of $1,750, or $875 per person. Rollovers are also permitted under the plan. **The disclosure statement required by the Internal Revenue Service to be furnished to individuals who are considering adopting an IRA may be obtained from the Fund.**

Corporate Retirement Plans—Prototype Profit-Sharing, Money Purchase Pension, and Thrift Plans are available for corporate employers who wish to establish and qualify one or more of such plans under Section 401 of the Internal Revenue Code.

For Employees of Educational and Charitable Organizations [403(b)]—A custodial agreement is available for public school systems and certain charitable organizations who wish to use mutual fund shares held in a custodial account to fund deferred compensation arrangements with their employees, pursuant to Section 403(b) of the Internal Revenue Code.

The minimum initial investment to establish a tax-sheltered plan through the Fund is $500; however, shareholders who have established such a plan through one of the other Price funds may open an account with the New Income Fund under the plan by investing $250 or more. Subsequent investments are subject to a minimum of $50 for each account. Plans established under a payroll deduction arrangement are subject to an initial and subsequent minimum purchase of $20 for each account.

All purchases and redemptions of Fund shares pursuant to any one of the Fund's tax-sheltered plans must be carried out in accordance with the provisions of the plan. Accordingly, all plan documents should be reviewed carefully before adopting or enrolling in the plan. Investors should especially note that a penalty tax of 10% may be imposed on early withdrawals under Keogh or IRA Plans. Investors should also note that under proposed Internal Revenue Service regulations, early withdrawal will be limited under 403(b) plans. It is recommended that an investor consult a tax adviser before investing in the Fund through any of these plans.

An investor participating in any of the Fund's special plans has no obligation to continue to invest in the Fund, and may terminate the plan with the Fund at any time. Except for expenses of sales and promotion, executive and administrative personnel, and certain services which are furnished by the investment adviser, the cost of the plans generally is borne by the Fund; however, each Keogh, IRA, and 403(b) Plan account is charged by the Bank an annual maintenance fee of $2.00.

DISTRIBUTIONS AND TAXES

Dividends are payable from the Fund's net investment income. In addition, it is the policy of the Fund to distribute substantially all of its net profits realized from the sale of portfolio securities, after offsetting against such profits any available capital loss carryover. It is the Fund's policy to pay dividends in April, July, October, and January, but the distribution dates and the amounts paid, if any, are subject to determination by the Board of Directors. Capital gains, if any, will normally be distributed after the end of the Fund's fiscal year.

Unless the shareholder elects otherwise, dividends and capital gain distributions are paid in additional shares which are credited to the shareholder's account. Any dividend and distribution election will remain in effect until the Bank is notified by the shareholder in writing to the contrary.

The Fund is qualified as a "regulated investment company" under the Internal Revenue Code and, therefore, pays no taxes on net income and net realized capital gains paid to shareholders. To qualify for this treatment, it is necessary for the Fund to derive at least 90% of its gross income from dividends, interest and gain from the sale or other disposition of securities; derive less than 30% of its gross income from the sale or other disposition of securities held less than three months;

invest in securities within certain limits; and distribute to its shareholders at least 90% of its net income earned in any year.

Dividends are taxable to shareholders as ordinary income. It is expected that only a nominal part of the dividends paid by the Fund will be eligible for the dividends-received exclusion or deduction. Of the dividends paid by the Fund in 1977, 5% were eligible for such exclusion and deduction. Capital gain distributions from the sale of securities will be taxable to the shareholder as long-term capital gains, regardless of the length of time the shares of the Fund have been held, and are tax preference items to the shareholder. Distributions may also be subject to state and local taxes. Dividend and capital gain distributions are taxable as described above regardless of whether they are paid in cash or in additional shares.

To the extent that the net asset value at the time of purchase reflects undistributed income or capital gains, or net unrealized appreciation of securities held by the Fund, a subsequent distribution to the shareholder of such amounts, although constituting a return of his investment, would be taxable as described above. On March 31, 1978, the books of the Fund indicated that the Fund's aggregate net assets included undistributed net income of $5,549,772, undistributed realized capital losses of $736,958, and unrealized appreciation of $801,170. For Federal income tax purposes, the Fund is permitted to carry forward its net realized capital losses and, therefore, will be able to incur net realized capital gains up to the amount of such losses without being required to pay tax on or distribute such gains, which would be taxable to shareholders as ordinary income. (For information as to the Fund's capital loss carryover for Federal income tax purposes, see Note 4 to the Fund's Financial Statements, page 29.)

Information concerning the tax status of dividends and distributions is mailed to shareholders annually.

PORTFOLIO TRANSACTIONS

Purchases and sales of portfolio securities are usually transacted with the issuer or with a primary market maker acting as principal for the securities on a net basis, with no brokerage commission being paid by the Fund. Transactions placed through dealers serving as primary market makers reflect the spread between the bid and the asked prices. Occasionally, the Fund may make purchases of underwritten issues at prices which include underwriting fees.

Decisions with respect to the purchase and sale of portfolio securities on behalf of the Fund are made by officers of the Fund, pursuant to recommendations made by Price Associates in its capacity as investment adviser. Officers of the Fund are generally responsible for implementing or supervising the implementation of these decisions, including the allocation of principal business and portfolio brokerage, and the negotiation of commissions. All of such officers are also officers or employees of Price Associates.

As specifically provided in the Investment Advisory Agreement between Price Associates and the Fund, the Board of Directors of the Fund is authorized to adopt a brokerage allocation policy embodying the concepts of Section 28(e) of the Securities Exchange Act of 1934, which was enacted by Congress in 1975 after the elimination of fixed brokerage commission rates. The Board of Directors has not yet adopted such policy. If such policy were adopted, the Fund could pay a broker-dealer which furnishes research services a higher commission than that which might be charged by

another broker-dealer which does not furnish research services, or which furnishes research services deemed to be of lesser value, if such commission is deemed reasonable in relation to the value of the brokerage and research services provided by the broker-dealer, viewed in terms of either that particular transaction or the overall responsibilities of Price Associates with respect to the accounts as to which it exercises investment discretion.

In purchasing and selling its portfolio securities, it is the Fund's policy to seek execution at the most favorable prices, through responsible broker-dealers and in agency transactions, at reasonably competitive commission rates. In selecting broker-dealers to execute the Fund's portfolio transactions, consideration will be given to such factors as the price of the security, the rate of commission, if any, the size and difficulty of the order, the reliability, integrity, financial condition and general execution and operational capabilities of competing broker-dealers, and the brokerage and research services which they provide to Price Associates or the Fund. Although Price Associates has been provided research by broker-dealers, it has not been the policy of the Fund to pay higher net prices or commissions than would otherwise be available specifically for the purpose of obtaining such research. On the basis of such information as is available in the industry, the Fund believes that it has, in fact, been able to obtain competitive net prices and commission rates on portfolio transactions on an overall basis.

The extent to which net prices or commissions charged by broker-dealers selected by the Fund may reflect an element of value for research services cannot presently be determined. To the extent that research services of value are provided by broker-dealers with or through whom the Fund places portfolio transactions, Price Associates may be relieved of expenses which it might otherwise bear. Research services furnished by broker-dealers could be useful and of value to Price Associates in serving its other clients as well as the Fund; but, on the other hand, certain research services obtained by Price Associates as a result of the placement of portfolio brokerage of other clients could be useful and of value to it in serving the Fund.

Since the Fund does not market its shares through intermediary brokers or dealers, it is not the Fund's practice to allocate principal business or brokerage on the basis of sales of its shares which may be made through such firms, although broker-dealers effecting purchases of Fund shares for their customers may participate in principal transactions or brokerage allocated as described above.

In 1977, 1976, and 1975, the Fund engaged in portfolio transactions involving broker-dealers totaling $465,474,184, $214,029,285, and $237,631,193, respectively. Of these amounts, $458,357,005, $192,023,685, and $191,792,368, respectively, consisted of principal transactions as to which the Fund has no knowledge of the profits or losses realized by the respective dealers; and $7,117,179, $22,005,600, and $45,838,825, respectively, involved trades with brokers acting as agents or underwriters in which such brokers received total commissions, including discounts received in connection with underwritings, of $57,400, $229,589, and $425,888, respectively. Of all such portfolio transactions, approximately 27%, 27%, and 33%, respectively, were placed with firms which provided research, statistical, or other services or facilities to Price Associates in connection with the management of the Fund or, in some cases, to the Fund.

A recent decision in the United States District Court for the Southern District of New York held that the investment adviser (one of the defendants in the case) to an investment company had a duty to "recapture" for the investment company, through the adviser's broker-dealer affiliate, the underwriting discounts and selling group concessions that were paid when the investment company acquired securities in underwritten offerings. The effect of recapture would have been to reduce the cost of acquiring such securities. In the case of an investment adviser such as Price Associates, which has no business other than rendering investment advisory services, in order to effect recapture for the Fund the investment adviser would have to become, or form an affiliate which would become, a broker-dealer, join the National Association of Securities Dealers, Inc. ("NASD"), and seek to become a member of underwriting syndicates or selling groups offering securities which are desired to be purchased by the Fund in underwritings.

The NASD has taken the position that recapture of underwriting discounts and selling group concessions in the manner contemplated by this case would violate the NASD's Rules of Fair Practice. The NASD has recently proposed a rule which would codify this position and which would, if adopted, prohibit NASD members from engaging in this practice. Before any such rule is finally adopted, it must be approved by the membership of the NASD, and by the SEC. The Fund is unable to predict whether the proposed rule will be adopted by the NASD and approved by the SEC and, if adopted, its ultimate form.

Because of the uncertainty as to the outcome of these proceedings, as well as uncertainty as to the impact of certain other developments which bear on this question (including, but not limited to, the effect of Section 11(a) of the Securities Exchange Act of 1934, which would prohibit broker-dealers who are members of a securities exchange from effecting transactions on that exchange after May 1, 1978 for institutional accounts as to which they exercise "investment discretion"), the directors of the Fund, after considering the matter with Price Associates, have determined that at this time it would be inappropriate for the Fund to request Price Associates to take steps intended to produce the recapture of underwriting discounts and selling group concessions. The directors of the Fund have determined to defer resolution of the issue, as it may affect the Fund, until the ultimate resolution of the questions before the NASD and other unsettled questions bearing on this issue. In the year 1977, the Fund purchased securities in underwritings at total prices of $4,994,750, of which $50,000 constituted underwriting discounts and selling group concessions.

The directors of the Fund have also considered the possibility of seeking recapture of brokerage commissions on portfolio transactions not involving underwritings, and the recapture of solicitation fees paid by the Fund in connection with tenders in response to tender offers. With respect to the former, the Board of Directors has concluded that the potential benefits obtainable from recapture are not likely to be greater than the benefits available to the Fund from the reduction in commission costs through negotiated rates. With respect to the latter, the directors have determined that the participation of the Fund in tenders is not sufficiently frequent to justify requesting Price Associates to become, or establish an affiliate which would become, a broker-dealer. In the year 1977, the Fund did not tender any securities in tender offers. If the Board of Directors determines to request that Price Associates arrange for recapture of underwriting discounts and selling group concessions, it will reconsider its determination with respect to brokerage commissions and tender offer solicitation fees.

The portfolio turnover rate of the Fund in each of the last three years has been as follows: 1977—29.6%, 1976—17.5%, and 1975—37.2%.

GENERAL INFORMATION

The authorized capital stock of the Fund consists of 100,000,000 shares, par value $1.00 per share, with equal rights as to voting, redemptions, dividends, distributions, and liquidations. Fractional shares have voting rights, and participate in dividends and distributions paid. The Fund will not issue any class of securities senior to any other class of securities. Shareholders do not have preemptive or conversion rights. Shares of the Fund, when issued, are fully paid and non-assessable.

Shares of the Fund do not have cumulative voting rights. This means that the holders of more than 50% of the shares voting in the election of directors can elect all of the directors and, in such event, the holders of the remaining shares voting in such election will not be able to elect anyone to the Board of Directors.

The Fund is registered as a diversified open-end investment company of the management type under the Investment Company Act of 1940. The shares of the Fund are registered for sale under the Securities Act of 1933, and the Fund, or its shares, are registered under the laws of all states requiring such registration, the District of Columbia, and Puerto Rico.

As of December 31, 1977, 28,343,535 shares of the Fund were outstanding, less than 1% of which were owned beneficially and of record by the directors and officers of the Fund. As of that date, approximately 4,687,892 shares of the Fund, representing approximately 16.5% of the outstanding stock, were registered to the Bank as custodian for shareholders in the T. Rowe Price Funds Retirement Plan for Self-Employed (Keogh) and the T. Rowe Price Funds Individual Retirement Account (IRA). The Bank has no beneficial interest in such accounts, nor in any other account which it may serve as custodian or trustee. As of that date approximately 2,966,397 shares of the Fund, representing approximately 10.5% of the outstanding stock, were owned by various private counsel clients of the Fund's investment adviser, Price Associates. Members of the firm of Shereff, Friedman, Hoffman & Goodman, counsel to the Fund, are shareholders of the Fund, and one member of that firm is a trustee of a trust which holds its shares.

EXPERTS

The financial statements of the Fund which follow have been included in this Prospectus in reliance upon the report of the firm of Price Waterhouse & Co., independent accountants, and upon their authority as experts in auditing and accounting.

APPENDIX—Debt Security Ratings

Moody's Investors Service, Inc.: **Aaa**—Best quality. These bonds carry the smallest degree of investment risk and are generally referred to as "gilt-edge". Interest payments are protected by a large, or by an exceptionally stable, margin and principal is secure. While the various protective elements are likely to change, such changes as can be visualized are most unlikely to impair the fundamentally strong position of such issues. **Aa**—High quality by all standards. Together with

the Aaa group, they comprise what are generally known as high-grade bonds. They are rated lower than the best bonds because margins of protection may not be as large as in Aaa securities, fluctuations of protective elements may be of greater amplitude, or there may be other elements present which make the long-term risks appear somewhat greater than in Aaa securities. **A**—Upper-medium-grade obligations. Factors giving security to principal and interest are considered adequate, but elements may be present which suggest a susceptibility to impairment sometime in the future. **Baa**—Medium-grade obligations; neither highly protected, nor poorly secured. Interest payments and principal security appear adequate for the present, but certain protective elements may be lacking or may be characteristically unreliable over any great length of time. Such bonds lack outstanding investment characteristics and, in fact, have speculative characteristics as well.

STANDARD & POOR'S CORPORATION: **AAA**—Highest grade obligations. They possess the ultimate degree of protection as to principal and interest. Marketwise, they move with interest rates, and hence provide the maximum safety on all counts. **AA**—High-grade obligations. In the majority of instances, they differ from AAA issues only in a small degree. Here, too, prices move with the long-term money market. **A**—Upper-medium grade. They have considerable investment strength, but are not entirely free from adverse effects of changes in economic and trade conditions. Interest and principal are regarded as safe. They predominantly reflect money rates in their market behavior but, to some extent, also economic conditions. **BBB**—Medium-grade; borderline between definitely sound obligations and those where the speculative element begins to predominate. These bonds have adequate asset coverage and normally are protected by satisfactory earnings. Their susceptibility to changing conditions, particularly to depressions, necessitates constant watching. Marketwise, the bonds are more responsive to business and trade conditions than to interest rates. This group is the lowest which qualifies for commercial bank investment.

ROWE PRICE NEW INCOME FUND, INC.

PORTFOLIO OF INVESTMENTS IN SECURITIES

DECEMBER 31, 1977

U.S. GOVERNMENT OBLIGATIONS, U.S. GOVERNMENT GUARANTEED OBLIGATIONS, FEDERAL AGENCIES, BANKERS' ACCEPTANCES, CERTIFICATES OF DEPOSIT & CORPORATE NOTES—30.1%	Rating (Standard & Poor's)	Principal Amount	Average Cost	Value (Note 1-A)
U.S. Government Obligations—2.8%				
U.S. TREASURY NOTES				
8%, 5/15/82	Aaa*	$ 4,000,000	$ 4,187,500	$ 4,090,000
7¼%, 8/15/84	Aaa*	3,800,000	3,846,312	3,728,180
			$ 8,033,812	$ 7,818,180
U.S. Government Guaranteed Obligations—0.6%				
UNITED STATES GOVERNMENT GUARANTEED SHIP FINANCING BONDS (EL PASO COLUMBIA TANKER COMPANY)				
Series A, S.F. Bonds, 9¼%, 3/31/03	AAA	$ 500,000	$ 500,000	$ 535,400
UNITED STATES GOVERNMENT GUARANTEED SHIP FINANCING BONDS (EL PASO SAVANNAH TANKER COMPANY)				
Series A, S.F. Bonds, 9¼%, 3/31/03	AAA	1,000,000	1,000,000	1,070,800
			$ 1,500,000	$ 1,606,200
Federal Agencies—6.0%				
FEDERAL HOME LOAN BANKS				
7.85%, 8/27/84		$ 250,000	$ 257,656	$ 251,725
FEDERAL NATIONAL MORTGAGE ASSOCIATION				
8¾%, 9/10/80		2,000,000	2,098,125	2,072,500
8.60%, 10/11/82		2,000,000	2,122,500	2,083,800
7.65%, 3/11/85		1,000,000	1,017,188	995,000
7¼%, 7/10/85		3,000,000	2,985,937	2,913,750
7.45%, 9/10/85		5,000,000	5,034,375	4,925,000
GOVERNMENT NATIONAL MORTGAGE ASSOCIATION				
9%, 11/15/04 (Mortgage Backed Security)		1,055,029	1,076,325	1,097,230
9%, 12/15/04 (Mortgage Backed Security)		1,976,542	2,013,216	2,055,604
9%, 2/15/05 (Mortgage Backed Security)		691,124	713,153	718,769
			$ 17,318,475	$ 17,113,378
Bankers' Acceptances—0.4%				
THE FUJI BANK, LTD.				
6.85%, 1/16/78		$ 100,000	$ 98,344	$ 98,344
THE SUMITOMO BANK, LIMITED				
6.97%, 2/23/78		1,000,000	978,122	978,122
			$ 1,076,466	$ 1,076,466
Certificates of Deposit—15.5%				
ALGEMENE BANK NEDERLAND NV				
7.10%, 5/15/78		$ 1,000,000	$ 1,000,000	$ 1,000,000
7.10%, 5/30/78		1,000,000	1,000,000	1,000,000
THE BANK OF NOVA SCOTIA, LONDON BRANCH				
7 9/16%, 4/13/78		1,000,000	1,000,888	1,000,888
CANADIAN IMPERIAL BANK OF COMMERCE, LONDON BRANCH				
7.15%, 4/24/78		2,000,000	2,000,330	2,000,330
CITIBANK, N.A., LONDON BRANCH				
6%, 2/6/78		2,000,000	2,002,160	2,002,160
8½%, 9/26/78		1,000,000	999,712	999,712

ROWE PRICE NEW INCOME FUND, INC.

PORTFOLIO OF INVESTMENTS IN SECURITIES (Cont'd)

DECEMBER 31, 1977

Certificates of Deposit (Cont'd)	Rating (Standard & Poor's)	Principal Amount	Average Cost	Value (Note 1-A)
COMMERZBANK AG				
6.90%, 1/3/78		$ 3,000,000	$ 3,000,517	$ 3,000,517
7%, 1/4/78		2,000,000	2,000,000	2,000,000
CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO				
7.35%, 9/12/79		2,500,000	2,500,000	2,500,000
CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO, LONDON BRANCH				
6.70%, 3/15/78		3,000,000	2,994,738	2,994,738
7¼%, 5/15/78		3,000,000	3,000,000	3,000,000
FIRST CITY NATIONAL BANK OF HOUSTON, LONDON BRANCH				
6.85%, 3/13/78		1,000,000	998,412	998,412
THE FUJI BANK, LTD.				
6.90%, 2/1/78		2,000,000	1,999,802	1,999,802
HARRIS TRUST AND SAVINGS BANK, LONDON BRANCH				
7%, 3/29/78		3,000,000	2,997,047	2,997,047
MORGAN GUARANTY TRUST COMPANY, LONDON BRANCH				
8⁷⁄₁₆%, 2/22/78		1,500,000	1,534,696	1,534,696
7¼%, 6/12/78		2,000,000	2,000,195	2,000,195
9⅜%, 9/8/80		1,000,000	1,064,000	1,064,000
THE ROYAL BANK OF CANADA, LONDON BRANCH				
7%, 3/29/78		3,000,000	2,995,937	2,995,937
SEATTLE-FIRST NATIONAL BANK, LONDON BRANCH				
7¹⁄₁₆%, 3/28/78		3,000,000	2,997,927	2,997,927
7.20%, 4/5/78		3,000,000	2,999,452	2,999,452
THE SUMITOMO BANK, LIMITED				
7%, 1/23/78		3,000,000	3,000,000	3,000,000
			$ 44,085,813	$ 44,085,813
Corporate Notes—4.8%				
CAISSE NATIONALE DES TELECOMMUNICATIONS				
6.93%, 4/3/78	A1	$ 850,000	$ 825,285	$ 825,285
CHESEBROUGH-POND'S INC.				
6.70%, 1/30/78	P1*	3,000,000	2,982,692	2,982,692
ELECTRICITE DE FRANCE				
7⅛%, 5/8/78	A1	1,800,000	1,735,875	1,735,875
7⅛%, 5/9/78	A1	3,775,000	3,640,516	3,640,516
7%, 5/30/78	A1	2,000,000	1,930,000	1,930,000
GENERAL MOTORS ACCEPTANCE CORPORATION				
6%, 1/5/78	A1	2,609,000	2,609,000	2,609,000
			$ 13,723,368	$ 13,723,368
TOTAL U.S. GOVERNMENT OBLIGATIONS, U.S. GOVERNMENT GUARANTEED OBLIGATIONS, FEDERAL AGENCIES, BANKERS' ACCEPTANCES, CERTIFICATES OF DEPOSIT & CORPORATE NOTES—30.1%			$ 85,737,934	$ 85,423,405
CORPORATE BONDS—47.0%				
Banking—0.5%				
MANUFACTURERS HANOVER CORPORATION				
Notes, 8⅜%, 12/1/82	Aaa*	$ 1,500,000	$ 1,500,000	$ 1,526,850

	Rating (Standard & Poor's)	Principal Amount	Average Cost	Value (Note 1-A)
Electric Utilities—11.9%				
CENTRAL ILLINOIS LIGHT COMPANY				
1st Mtg., 9¼%, 5/1/06	A	$ 2,000,000	$ 1,972,625	$ 2,089,200
CONSOLIDATED EDISON COMPANY OF NEW YORK, INC.				
1st Mtg., 9⅛%, 3/1/04	A–	5,000,000	4,869,000	4,987,500
FLORIDA POWER & LIGHT COMPANY				
Notes, 10¾%, 11/15/81	BBB+	1,000,000	1,041,677	1,051,250
1st Mtg., 9⅛%, 5/1/84	A+	450,000	439,875	473,625
1st Mtg., 10⅛%, 3/1/05	A+	735,000	775,425	762,563
1st Mtg., 9⅜%, 6/1/06	A+	2,500,000	2,539,200	2,625,000
JERSEY CENTRAL POWER & LIGHT COMPANY				
1st Mtg., 9⅝%, 2/1/06	A–	4,500,000	4,550,495	4,715,550
THE MONTANA POWER COMPANY				
1st Mtg., 9.70%, 12/1/05	A	2,500,000	2,610,000	2,687,500
PACIFIC POWER & LIGHT COMPANY				
1st Mtg., 10%, 1/1/06	BBB+	5,000,000	5,159,173	5,362,500
POTOMAC ELECTRIC POWER COMPANY				
1st Mtg., 10¼%, 8/15/81	A+	1,250,000	1,244,375	1,325,500
1st Mtg., 10¾%, 8/15/04	A+	500,000	500,000	565,625
ROCHESTER GAS AND ELECTRIC CORPORATION				
1st Mtg., Series AA, 10¾%, 8/1/83	A	1,384,000	1,400,311	1,502,747
1st Mtg., Series Z, 9⅛%, 9/1/00	A	250,000	266,875	256,350
1st Mtg., Series BB, 9¼%, 6/15/06	A	3,250,000	3,223,750	3,377,400
SOUTHERN CALIFORNIA EDISON COMPANY				
1st & Ref. Mtg., Series EE, 9%, 11/1/81	AA	1,000,000	995,000	1,027,900
SOUTHWESTERN ELECTRIC POWER COMPANY				
1st Mtg., Series M, 9⅝%, 8/1/05	AA	1,000,000	999,482	1,080,800
			$ 32,587,263	$ 33,891,010
Finance & Credit—8.4%				
AMERICAN EXPRESS CREDIT CORPORATION				
Senior Notes, 9½%, 6/15/82	AA	$ 2,215,000	$ 2,257,040	$ 2,338,597
Senior Notes, 8½%, 12/15/85	AA	1,000,000	1,000,000	1,028,750
FORD MOTOR CREDIT COMPANY				
Notes, 9¾%, 10/1/81	AA–	750,000	782,188	788,438
Notes, 8⅝%, 1/15/83	AA–	2,000,000	2,100,000	2,050,000
S.F. Deb., 9½%, 1/15/95	AA–	4,200,000	4,372,438	4,501,140
S.F. Deb., 9.70%, 7/15/00	AA–	3,000,000	3,219,238	3,277,500
J.C. PENNEY FINANCIAL CORPORATION				
Deb., 9.45%, 10/15/81	A	1,000,000	1,013,875	1,040,400
PULLMAN LEASING COMPANY				
Equipment Trust Certificates,				
Series 1, 10%, 6/15/85	A	1,093,000	1,131,829	1,153,989
Series 6, 9.45%, 6/15/95	A	1,405,000	1,411,663	1,484,031
UT CREDIT CORPORATION				
Notes, 8⅝%, 6/1/86	A+	3,000,000	2,987,500	3,087,600
UNION TANK CAR COMPANY				
Equipment Trust Certificates,				
Series 11, 8⅞%, 12/15/80	A	1,500,000	1,500,000	1,534,950
Series 13, 9½%, 12/15/95	A	1,400,000	1,430,000	1,490,440
			$ 23,205,771	$ 23,775,835

ROWE PRICE NEW INCOME FUND, INC.

PORTFOLIO OF INVESTMENTS IN SECURITIES (Cont'd)

DECEMBER 31, 1977

	Rating (Standard & Poor's)	Principal Amount	Average Cost	Value (Note 1-A)
Gas & Gas Transmission—6.0%				
ARKANSAS LOUISIANA GAS COMPANY				
1st Mtg., 10½%, 9/1/95	A+	$ 2,450,000	$ 2,633,875	$ 2,693,040
THE COLUMBIA GAS SYSTEM, INC.				
Deb., 9⅝%, 11/1/89	A	2,500,000	2,526,125	2,644,750
HOUSTON NATURAL GAS CORPORATION				
S.F. Deb., 9¾%, 2/1/95	A+	3,700,000	3,745,783	3,931,250
KANSAS-NEBRASKA NATURAL GAS COMPANY, INC.				
S.F. Deb., 9%, 1/1/96	A+	974,000	969,130	1,000,395
NORTHERN NATURAL GAS COMPANY				
S.F. Deb., 9%, 5/1/85	A+	1,000,000	995,000	1,044,600
S.F. Deb., 9%, 11/1/95	A+	3,250,000	3,301,375	3,344,900
PIONEER CORPORATION				
Deb., 9½%, 12/15/82	A	2,156,000	2,187,459	2,250,325
			$ 16,358,747	$ 16,909,260
Industrial—11.3%				
ANHEUSER-BUSCH, INCORPORATED				
S.F. Deb., 9.20%, 4/1/05	AA	$ 1,000,000	$ 1,017,500	$ 1,078,300
CYPRUS MINES CORPORATION				
Notes, 8¾%, 1/15/85	A	3,400,000	3,418,250	3,441,140
DIAMOND SHAMROCK CORPORATION				
S.F. Deb., 9%, 4/1/99	A	4,750,000	4,906,238	5,023,125
DIGITAL EQUIPMENT CORPORATION				
S.F. Deb., 9⅜%, 3/15/00	A	3,650,000	3,717,342	3,928,313
HUGHES TOOL COMPANY				
S.F. Deb., 9%, 7/15/00	A	1,000,000	988,750	1,046,700
TEXASGULF, INC.				
Deb., 9⅜%, 12/15/00	A+	11,000,000	11,717,500	11,852,500
UNITED TECHNOLOGIES CORPORATION				
S.F. Deb., 9⅞%, 4/15/00	A+	5,050,000	5,331,625	5,542,375
			$ 31,097,205	$ 31,912,453
Petroleum—3.3%				
BP NORTH AMERICAN FINANCE CORPORATION				
Guaranteed Deb., 10%, 8/15/00	AA	$ 5,000,000	$ 5,263,695	$ 5,475,000
Guaranteed Deb., 9¼%, 2/1/01	AA	1,000,000	1,020,000	1,057,500
CITIES SERVICE COMPANY				
S.F. Deb., 9¾%, 10/1/00	A	750,000	825,000	821,550
CONTINENTAL OIL COMPANY				
S.F. Deb., 8⅞%, 6/1/01	AA	2,000,000	2,006,250	2,085,000
			$ 9,114,945	$ 9,439,050
Railroads—0.3%				
THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY				
Equipment Trust Certificates, Series B, 8¾%, 3/15/85	AAA	$ 830,000	$ 835,312	$ 861,789
Telephone—1.7%				
THE BELL TELEPHONE COMPANY OF PENNSYLVANIA				
Deb., 9⅝%, 7/15/14	AAA	$ 1,000,000	$ 997,500	$ 1,096,700
THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY				
Deb., 9⅝%, 9/1/15	AAA	500,000	560,000	548,125

Telephone (Cont'd)	Rating (Standard & Poor's)	Principal Amount	Average Cost	Value (Note 1-A)
THE PACIFIC TELEPHONE AND TELEGRAPH COMPANY				
Notes, 9%, 10/15/81	AA–	$ 500,000	$ 498,750	$ 513,750
Deb., 9½%, 6/15/11	AA–	2,500,000	2,579,010	2,693,750
			$ 4,635,260	$ 4,852,325
Transportation—3.6%				
BRANIFF AIRWAYS, INCORPORATED				
Senior Notes, 10%, 7/1/86	BBB–	$ 7,550,000	$ 7,890,438	$ 7,902,585
RYDER SYSTEM, INC.				
Collateral Trust Deb., 10%, 5/15/94	BBB	2,150,000	2,247,500	2,259,220
			$ 10,137,938	$ 10,161,805
TOTAL CORPORATE BONDS—47.0%			$129,472,441	$133,330,377
CANADIAN[1]—10.6%				
BRITISH COLUMBIA HYDRO AND POWER AUTHORITY				
Bonds, Series DN, 10¼%, 10/1/99	AA	$ 1,850,000	$ 1,997,188	$ 2,042,770
Bonds, 9⅝%, 6/1/05	AA	6,550,000	6,846,417	6,956,755
THE MANITOBA HYDRO-ELECTRIC BOARD				
Bonds, Series 3H, 9⅜%, 12/1/04	AA	5,500,000	5,621,362	5,713,125
MONTREAL URBAN COMMUNITY				
S.F. Deb., 10⅞%, 10/1/00	A	3,464,000	3,592,168	3,606,890
MUNICIPAL FINANCE AUTHORITY OF BRITISH COLUMBIA				
S.F. Deb., 9¾%, 1/15/00	AA	708,000	704,207	738,090
NEW BRUNSWICK ELECTRIC POWER COMMISSION				
Deb., 10½%, 10/1/95	A+	1,500,000	1,599,955	1,650,000
Deb., 10%, 1/15/05	A+	2,100,000	2,121,000	2,245,320
NOVA SCOTIA POWER CORPORATION				
S.F. Deb., 10½%, 9/15/00	A+	2,900,000	3,217,750	3,187,680
PROVINCE OF ONTARIO				
Deb., 10¼%, 10/1/04	AAA	500,000	500,000	556,250
Deb., 9⅛%, 6/15/05	AAA	1,000,000	1,059,300	1,027,900
Deb., 8¾%, 1/5/08	AAA	2,500,000	2,500,000	2,481,250
			$ 29,759,347	$ 30,206,030
FOREIGN[2]—7.6%				
CAISSE NATIONALE DES TELECOMMUNICATIONS				
Guaranteed External Notes, 9⅛%, 3/15/80	AAA	$ 4,500,000	$ 4,638,781	$ 4,588,200
EUROPEAN COAL AND STEEL COMMUNITY				
Notes, 8⅞%, 12/15/80	AAA	5,750,000	5,955,625	5,862,700
REPUBLIC OF VENEZUELA				
Notes, 7⅞%, 6/15/82	AAA	10,000,000	10,031,375	9,833,000
SOCIETE NATIONALE DES CHEMINS DE FER FRANCAIS				
Guaranteed Notes, 9⅛%, 4/15/80	AAA	1,100,000	1,127,063	1,121,560
			$ 21,752,844	$ 21,405,460
PREFERRED STOCK—0.9%				
Electric Utilities—0.5%		Shares		
FLORIDA POWER & LIGHT COMPANY				
10.08% Cumulative, Series J	A	12,500	$ 1,268,750	$ 1,391,625

ROWE PRICE NEW INCOME FUND, INC.

PORTFOLIO OF INVESTMENTS IN SECURITIES (Cont'd)

DECEMBER 31, 1977

	Rating (Standard & Poor's)	Shares	Average Cost	Value (Note 1-A)
Gas and Gas Transmission—0.4%				
MONTANA-DAKOTA UTILITIES CO.				
11% Series, Cumulative	BBB	10,030	$ 1,026,056	$ 1,124,162
TOTAL PREFERRED STOCK—0.9%			$ 2,294,806	$ 2,515,787
PREFERENCE STOCK—1.5%				
Electric Utilities—1.5%				
IOWA-ILLINOIS GAS AND ELECTRIC COMPANY				
$2.31 Series, Cumulative	A	76,720	$ 1,918,000	$ 2,033,080
$10.75 Series, Cumulative	A	15,000	1,460,671	1,698,750
PENNSYLVANIA POWER & LIGHT COMPANY				
$11.00 Series, Cumulative	BBB	5,000	500,000	557,500
			$ 3,878,671	$ 4,289,330
TOTAL INVESTMENTS		97.7%	$272,896,043‡	$277,170,389
OTHER ASSETS LESS LIABILITIES		2.3%	$ 6,412,517	$ 6,412,517
NET ASSETS		**100.0%**	**$279,308,560**	**$283,582,906**

* Moody's Investors Service, Inc.

‡ The total aggregate cost for Federal tax purposes is $272,912,822

[1] This category includes marketable securities (payable in U.S. dollars) issued or guaranteed by the Government of Canada, any Province of Canada, or any instrumentality or political subdivision thereof.

[2] This category includes marketable securities (payable in U.S. dollars) issued or guaranteed by a foreign government or community.

STATEMENT OF ASSETS AND LIABILITIES

DECEMBER 31, 1977

Assets		
Investments in securities at value (Note 1-A)		
U.S. Government obligations (average cost—$8,033,812)	$ 7,818,180	
Other companies (average cost—$264,862,231)	269,352,209	$277,170,389
Cash		880,171
Receivables		
Dividends and interest	$ 5,480,264	
Investment securities sold	3,507,531	
Fund shares sold	456,441	9,444,236
Deferred expenses (Note 1-D)		40,331
Total Assets		$287,535,127
Liabilities		
Payables		
Investment securities purchased	$ 2,500,000	
Fund shares redeemed	1,270,680	
Accrued expenses and other payables	181,541	
Total Liabilities		3,952,221
Net Assets—equivalent to $10.01 per share based on 28,343,535 shares of capital stock outstanding (Note 3)		$283,582,906

For additional information about computation of net asset value and offering price per share, see page 10

ROWE PRICE NEW INCOME FUND, INC.

STATEMENT OF OPERATIONS

YEAR ENDED DECEMBER 31, 1977

Investment Income		
Income		
Dividends		$ 925,928
Interest		19,745,348
Total income		$ 20,671,276
Expenses		
Investment advisory fee (Note 5)	$ 1,158,773	
Transfer and dividend disbursing fees	109,645	
Custodian fee	14,059	
Legal and auditing fees	35,177	
Registration fees and expenses	39,676	
Stationery, printing and postage	62,017	
Stockholders' reports	27,058	
Directors' fees (Note 5)	10,000	
Miscellaneous	3,990	
Total expenses		1,460,395
Net Investment Income		$ 19,210,881
Realized and Unrealized Gain (Loss) On Investments		
Realized gain (loss) from security transactions (Note 4)		
Proceeds from sales of securities	$ 59,909,670	
Less cost of securities sold	58,881,663	
Net realized gain		$ 1,028,007
Unrealized appreciation (depreciation) of investments		
Beginning of period	$ 10,609,292	
End of period	4,274,346	
Unrealized depreciation of securities for the period		(6,334,946)
Net Realized And Unrealized Loss On Investments For The Period		$ (5,306,939)
Ratio of total expenses to total income		7.06%

For additional information see Notes To Financial Statements

ROWE PRICE NEW INCOME FUND, INC.

STATEMENT OF CHANGES IN NET ASSETS

	Year Ended December 31,		
	1977	1976	1975
From Investment Activities			
Net investment income	$ 19,210,881	$ 12,898,356	$ 6,932,294
Undistributed investment income included in price of shares sold and redeemed (Note 1-E)	553,124	813,643	690,546
	$ 19,764,005	$ 13,711,999	$ 7,622,840
Dividends to shareholders (1977—$0.7703 per share; 1976—$0.7825 per share; 1975—$0.7893 per share)	(18,445,348)	(11,879,575)	(6,440,670)
Increase in undistributed net investment income	$ 1,318,657	$ 1,832,424	$ 1,182,170
Net realized gain (loss) from security transactions	1,028,007	674,148	(170,032)
Unrealized appreciation (depreciation) of securities for each period	(6,334,946)	8,936,440	2,434,134
Increase (Decrease) In Net Assets Derived From Investment Activities	$ (3,988,282)	$ 11,443,012	$ 3,446,272
From Capital Share Transactions (exclusive of amounts allocated to investment income) (Note 3)			
Proceeds from sale of shares	$124,613,607	$108,581,239	$ 71,664,005
Net asset value of shares issued in payment of dividends	12,419.892	8,050,450	4,223,750
	$137,033,499	$116,631,689	$ 75,887,755
Payment for shares redeemed	(61,001,395)	(30,473,329)	(15,103,637)
Increase In Net Assets Derived From Capital Share Transactions	$ 76,032,104	$ 86,158,360	$ 60,784,118
Net Increase In Net Assets For The Period	$ 72,043,822	$ 97,601,372	$ 64,230,390
Net Assets			
Beginning of period	211,539,084	113,937,712	49,707,322
End of period (including undistributed net investment income of $5,474,524, $4,155,867, and $2,323,443, respectively)	$283,582,906	$211,539,084	$113,937,712

For additional information see Notes To Financial Statements

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1977

Note 1—Significant Accounting Policies

A—Security valuation—Investments in securities are valued at representative bid prices quoted by major dealers in such securities, except short-term U.S. Government obligations and Federal agencies, bankers' acceptances, certificates of deposit and corporate notes which are stated at cost which, when combined with accrued interest receivable, approximates value.

B—Federal income taxes—No provision for Federal income taxes is required since the Fund intends to distribute all of its taxable income and otherwise continue to comply with provisions of the Internal Revenue Code available to regulated investment companies.

C—Security transactions and related investment income—Security transactions are accounted for on the trade date and dividend income is recorded on the ex-dividend date. Interest income is recorded on the accrual basis. Realized gains and losses from security transactions and unrealized appreciation and depreciation of investments are reported on an average cost basis. Dividends and distributions to shareholders are recorded by the Fund on the ex-dividend date.

D—Registration fees—SEC and state registration fees are amortized over the effective period of the applicable registrations.

E—Equalization—The Fund follows the practice known as "equalization" under which a portion of the price of capital stock issued and redeemed equivalent to the per share amount of undistributed investment income on the date of the transaction is credited or charged to undistributed income. As a result, undistributed income per share is unaffected by Fund shares sold or redeemed.

Note 2—Dividends and Distributions

It is the Fund's policy to pay dividends from net investment income at quarterly or more frequent intervals and to distribute net realized gains, if any, from security transactions annually in the succeeding year together with the payment of the January dividend. A quarterly dividend of $0.1930 per share from undistributed net investment income at December 31, 1977, and a capital gain distribution of $0.0157 per share from net realized gains from security transactions for the year ended December 31, 1977, were declared payable on January 12, 1978 to shareholders of record on January 4, 1978.

Note 3—Capital Stock

At December 31, 1977, there were 100,000,000 shares of $1.00 par value capital stock authorized. Transactions in capital stock were as follows:

	Year Ended December 31		
	1977	1976	1975
Shares sold ...	12,583,386	11,163,239	7,663,220
Shares issued in payment of dividends ...	1,249,837	832,626	456,279
	13,833,223	11,995,865	8,119,499
Shares redeemed ...	(6,163,978)	(3,121,546)	(1,614,747)
Net increase for the period ..	7,669,245	8,874,319	6,504,752

Note 4—Purchases and Sales of Securities

Purchases and sales of securities other than U.S. Government obligations and short-term

NOTES TO FINANCIAL STATEMENTS (Cont'd)

DECEMBER 31, 1977

securities aggregated $79,800,306 and $59,909,670, respectively. Purchases and sales of U.S. Government obligations were $17,261,563 and $10,726,641, respectively. The net realized gain from security transactions for Federal income tax purposes for the year ended December 31, 1977, was $1,028,007. Capital gains of $448,050 which remained after the offset of capital loss carryovers were distributed to shareholders of record on January 4, 1978.

Note 5—Investment Adviser and Remuneration of Directors

The Investment Advisory Agreement between the Fund and Price Associates provides for an annual investment advisory fee, payable in monthly installments, based on the average daily net assets of the Fund at the annual rate of ½ of 1% of the first $100,000,000, 45/100 of 1% of the next $100,000,000, and 4/10 of 1% of such assets in excess of $200,000,000.

Three of the five directors of the Fund and all of its officers are either officers, directors, employees, or former employees of the Fund's adviser. During the year ended December 31, 1977, the Fund paid no compensation to its officers or directors except for fees paid to the directors not affiliated with the Fund's adviser at an annual fee of $5,000 per director.

Note 6—Supplementary Information

Reference is made to page 4 of this Prospectus for Per Share Income and Capital Changes information.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders and Board of Directors
of Rowe Price New Income Fund, Inc.

In our opinion, the accompanying statement of assets and liabilities (including the portfolio of investments in securities) and the related statements of operations and changes in net assets present fairly the financial position of Rowe Price New Income Fund, Inc. at December 31, 1977, the results of its operations for the year then ended and the changes in net assets for the three years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances, including confirmation of securities owned at December 31, 1977 by correspondence with the custodian and brokers.

PRICE WATERHOUSE & CO.

Baltimore, Maryland
January 20, 1978

NEW ACCOUNT ORDER

(For initial purchase by mail only)
(Do Not Use for Check Deposit, Cash Withdrawal, T. Rowe Price Keogh and IRA Plans—Request Separate Applications)

MAIL TO:
Rowe Price New Income Fund, Inc.
100 East Pratt Street
Baltimore, Maryland 21202

Date_____

Enclosed is my check, payable to **Price New Income Fund,** for $_____ to purchase the maximum full and fractional shares of the Fund. (minimum $1,000)

PLEASE CHECK APPROPRIATE BOX: ☐ This is my initial order to purchase shares.
☐ This relates to the purchase order previously submitted by letter ☐ phone ☐ on _____ DATE

INSTRUCTIONS If you need assistance in completing this application, please call 1-800-638-1527 **Toll Free** or 301-547-2136 Collect

REGISTRATION

PLEASE PRINT

Individual use line 1

1. Individual _____
FIRST NAME INITIAL LAST NAME SOC. SEC. NO.

Joint Tenancy use lines 1 & 2

2. Joint Tenancy _____
FIRST NAME INITIAL LAST NAME SOC. SEC. NO.
("JOINT TENANTS WITH RIGHT OF SURVIVORSHIP AND NOT AS TENANTS IN COMMON" UNLESS OTHERWISE SPECIFIED)

Gifts to Minors use line 3

3. Gifts to Minors _____
CUSTODIAN'S NAME (ONLY ONE CAN BE NAMED)

MINOR'S NAME (ONLY ONE) MINOR'S SOC. SEC. NO.

Under the _____ Uniform Gifts to Minors Act
STATE OF RESIDENCE

Corporations, Trusts, or others in any fiduciary capacity use line 4

4. Corporations, Trusts, etc. _____
NAME

TAX I.D. NO.

DATE OF TRUST INSTRUMENT NAME OF BENEFICIARY (IF TO BE INCLUDED IN REGISTRATION)

NAME OF TRUSTEES (IF TO BE INCLUDED IN REGISTRATION)

ADDRESS

STREET TELEPHONE NO. (INCLUDE AREA CODE)

CITY STATE ZIP

CITIZEN OF ☐ United States ☐ Other _____ ☐ I am of legal age in my state of residence.

DISTRIBUTIONS

Please pay my dividends as marked below: Please check ONE.

☐ Dividends and capital gain distributions automatically reinvested in additional shares.
☐ Dividends in cash with capital gain distributions reinvested.
☐ Dividends and capital gain distributions in cash.

If no box is checked, all dividends and capital gain distributions will be reinvested, increasing your shares.

EXPEDITED REDEMPTION OR EXCHANGE

My choice(s) of several methods of redeeming my shares is marked below.

☐ Check this box if you wish to redeem or exchange by telephone or telegram. Information will be sent to you.
☐ Check this box if you wish to write checks. Information will be sent to you.

You may also redeem or exchange by mail as explained in the Fund's Prospectus.

PLEASE SIGN

SIGNATURE:

OWNER, TRUSTEE, CUSTODIAN, ETC.

JOINT OWNER, CO-TRUSTEE, ETC.

An order is not binding on the Fund until it has been confirmed in writing by the Bank and payment has been received. The purchase, sale, and issuance of shares shall be governed by the laws of the State of Maryland, and the passage of title and the delivery of shares shall be deemed to take place in Maryland.

REV. 4/78

INVESTMENT ADVISER
T. Rowe Price Associates, Inc.
100 East Pratt Street
Baltimore, Maryland 21202
1-800-638-1527 (Toll Free)
547-2000 (Call Collect in Area 301)

CUSTODIAN AND TRANSFER AGENT
State Street Bank and Trust Company
P.O. Box 2357
Boston, Massachusetts 02107
1-800-225-5132 (Toll Free)
328-5000 (Call Collect in Massachusetts)

INDEPENDENT ACCOUNTANTS
Price Waterhouse & Co.
100 Light Street
Baltimore, Maryland 21202

COUNSEL
Shereff, Friedman, Hoffman & Goodman
919 Third Avenue
New York, New York 10022

This Prospectus omits certain of the information contained in the registration statement filed with the Securities and Exchange Commission. Items of information which are thus omitted may be obtained from the Securities and Exchange Commission upon payment of the fee prescribed by the Rules and Regulations of the Commission.

Prospectus

May 1, 1978

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ROWE PRICE NEW INCOME FUND, INC.

A NO-LOAD FUND

ROWE PRICE NEW INCOME FUND, INC.

A NO-LOAD FUND

Supplement to Prospectus Dated May 1, 1978

OFFICERS AND DIRECTORS

On July 26, 1978, the Board of Directors of the Fund elected George J. Collins a Director. At the same time, Mr. Collins was elected President and Chief Executive Officer. Prior to this, Mr. Collins had served as Executive Vice President. Carter O. Hoffman, who was formerly President, was elected to the position of Chairman of the Board.

The date of this Supplement is August 7, 1978.

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ROWE PRICE NEW INCOME FUND, INC.
100 EAST PRATT STREET, BALTIMORE, MARYLAND 21202

1-800-638-1527 (Toll Free)
1-301-547-2136 (Collect)

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Dear Employee of the State of Illinois:

RE: PUTTING YOUR MONEY INTO A BETTER FUTURE FOR YOURSELF—NOT INTO TAXES NOW

We Hope Three Things Will Encourage You to Join Our Income Program:

- High income and stability on your savings—Plus
- Income tax deferral on each dollar you save—leaving you more to save—Plus
- All income earned compounds tax sheltered—building up much faster than if you paid taxes and then saved.

You will, of course, have to pay income taxes when you eventually take money out of the program. But in the meanwhile—maybe for many years—you can, in effect, keep your money working for you that otherwise would have to be paid out in taxes now.

What is the Rowe Price New Income Fund?

It is a unique alternative to savings programs that pay a "fixed" rate of return. The New Income Fund is the largest of a number of no-load (no sales commission) bond funds which operate as follows:

1) You combine your money with other investors—many of whom are public employees in other states, cities, counties and agencies.

2) T. Rowe Price Associates, one of the largest investment management organizations in the world, invests your money in quality, fixed-income securities and actively supervises your investment daily.

3) This gives you broad diversification and professional management looking for the best opportunities day by day to increase your income and conserve and enhance the value of your capital.

4) The uniqueness, we mentioned, is that through our Fund **you** receive **all** income and capital gains earned on your money—less only modest management expenses of roughly 6/10 of 1% annually as detailed in our prospectus.

 We do **not** take your money, pay you a stated interest rate, and then keep all we are able to earn above that (which is the basis of most fixed-rate savings programs). The net earnings all belong to you.

5) If this is such a good deal, is there a catch? No, being no-load (no sales commission) and charging only a modest overall management expense, makes the Rowe Price New Income Fund one of the least expensive ways to invest with professional management that we know of.
 There is, however, a difference between this and most fixed-income programs. Our rate of return will change from day to day and the price of our shares will fluctuate. The Fund represents an investment in quality bonds and they in turn reflect the changing world of interest rates. During the life of the Fund, the price per share has fluctuated largely between $9.00 and $10.00 per share as indicated in the following table of year-end prices.

History of Per Share Prices

Date	Net Asset Value
8/31/73 Original Offering Price	$10.00
12/31/73	9.97
1974	9.39
1975	9.66
1976	10.23
1977	10.01
1978	9.66

Yield

On February 1, 1979, the Fund's price was $9.55 and the last annualized quarterly yield was 9.0% to its shareholders.

Yields and prices will change, a little, virtually every day and there is always the possibility the yield and price will someday exceed, or be lower, than the range previously mentioned. We are constantly trying to make your money work as hard as possible for you. And, you always know where you stand. The price of the Fund's shares are quoted daily in most large newspapers.

WHAT DO WE DO WITH YOUR MONEY?

Good Quality

First of all, we limit our investment selection to income-producing securities of investment quality. Using a scale of 1 to 10 (1 being the highest quality), the following table shows the Fund's present investments by quality ranking.

DIVERSIFICATION*—BY QUALITY—DECEMBER 31, 1978

TRP Quality Rating	Percent of Market Value
1	41.1%
2	40.1
3	11.5
4	7.3
5-10**	0.0
	100.0%

* Excludes other assets less liabilities
** It is the policy of the Fund not to invest in any securities below grade 4.

As we change investments, seeking the best opportunities for you, we may raise or lower the average quality. But, always in the context that our bias is toward high quality.

Flexible Maturity

Secondly, in order to obtain the best combination of yield and protection of your money, we will frequently be changing the average maturity of the bonds held. At a moment, such as the present, when we are particularly stressing protection, the average maturity may be relatively short. Conversely, it may be relatively long when we are emphasizing yield and/or possible capital gains. How the average maturity has changed over the last 12-month period is illustrated in the following table.

DIVERSIFICATION*—BY LENGTH OF MATURITY

	Percent of Market Value	
	12/31/77	12/31/78
Short-Term (0 to 2 years)	22.7%	81.9%
Intermediate-Term (2+ to 10 years)	22.0	7.3
Long-Term (over 10 years)	49.3	10.8

* Includes other assets less liabilities

Wide Diversification

Finally, we commit your money to as many as 100 or more individual securities with as many as 15 or more different types of corporate or government borrowers. As our portfolio indicates, these include large banks, huge industrial corporations, important utilities, and the United States and other government bodies.

The following table indicates a high degree of commitment presently to bank certificates of deposit. This is because they are both safe and of short maturity. But, unlike the certificates of deposit individual investors use, these are large, "negotiable" CD's available in amounts of $1 million and carrying at this time rates as high as 11½%, or more.

DIVERSIFICATION*— BY SECTOR OR INDUSTRY—DECEMBER 31, 1978

	Percent of Market Value
Domestic Negotiable CD's	35.3%
Eurodollar Negotiable CD's	31.6
Canadian	4.5
Bankers' Acceptances	4.3
Industrial	3.9
Foreign (other than Canadian)	3.9
Electric Utilities	3.5
Transportation (other than railroads)	3.5
Banking	2.5
Gas & Gas Transmission	2.0
Petroleum	1.9
U.S. Government & Agencies	1.4
Telephone	1.2
Finance & Credit	0.5
Railroads	0.0
TOTAL INVESTMENTS	100.0%

* Excludes other assets less liabilities

This, perhaps as much as anything, illustrates the advantages that can be gained by professional management dealing in large amounts of money for our shareholders. As our name New Income Fund indicates, we believe it is possible to obtain a higher return on savings and fixed-income monies through new avenues of income investing and through new professionalism in the management of money. Every day new opportunities arise which could improve one's fixed-income program. But they usually require a lot of knowledge and a lot of money. One of the purposes of the New Income Fund is to help you participate in these opportunities without having to become an expert or having a lot of capital.

- Take advantage of this new opportunity to put your money into a better future for yourself—not into taxes now.
- Try our New Income Fund—we think you will find it very productive over the long term.
- Try our services. Through the plan administrator and through our toll-free telephone number, we will give you excellent service.
- Try to sign up today—you'll protect your income from the IRS that much sooner.

ROWE PRICE NEW INCOME FUND, INC.
1-800-638-1527

ROWE PRICE NEW INCOME FUND, INC.

PORTFOLIO OF INVESTMENTS IN SECURITIES

DECEMBER 31, 1978

FEDERAL AGENCIES, BANKERS' ACCEPTANCES, CERTIFICATES OF DEPOSIT & CORPORATE NOTES—77.6%	Principal Amount	Average Cost	Value (Note 1-A)
Federal Agencies—1.4%			
FEDERAL NATIONAL MORTGAGE ASSOCIATION			
8.75%, 9/10/80	$ 2,000,000	$ 2,098,125	$ 1,955,000
8.60%, 10/11/82	2,000,000	2,122,500	1,942,500
		$ 4,220,625	$ 3,897,500
Bankers' Acceptances—4.2%			
BANK OF AMERICA NT&SA			
10.17%, 1/31/79	$ 4,000,000	$ 3,919,770	$ 3,918,680
CITIBANK, N.A.			
10.13%, 2/9/79	1,000,000	983,961	983,960
MORGAN GUARANTY TRUST COMPANY			
10⅜%, 1/10/79	5,000,000	4,910,659	4,908,650
THE SUMITOMO BANK, LIMITED			
9.90%, 1/4/79	2,000,000	1,961,500	1,961,040
		$ 11,775,890	$ 11,772,330
Certificates of Deposit—65.5%			
AMERICAN SAVINGS AND LOAN ASSOCIATION			
11.17%, 2/28/79	$ 5,000,000	$ 5,001,482	$ 5,000,650
AMERICAN SECURITY BANK, N.A.			
10.70%, 3/1/79	5,000,000	5,000,000	4,997,450
BANK OF AMERICA NT&SA			
10⅜%, 1/22/79	7,000,000	7,000,296	6,999,650
10½%, 1/29/79	2,000,000	2,000,090	2,000,040
CALIFORNIA FEDERAL SAVINGS AND LOAN ASSOCIATION			
11.35%, 1/22/79	5,000,000	5,000,000	5,000,000
CITIBANK, N.A.			
9.15%, 1/8/79	5,000,000	5,000,000	4,997,950
COMMERZBANK AG			
10.90%, 1/22/79	5,000,000	5,000,000	4,999,350
CONTINENTAL ILLINOIS NATIONAL BANK AND TRUST COMPANY OF CHICAGO			
10¼%, 1/2/79	2,000,000	2,000,000	2,000,000
9½%, 2/15/79	5,000,000	5,000,000	4,991,900
10%, 4/18/ 79	5,000,000	5,000,000	4,979,350
7.35%, 9/12/79	2,500,000	2,500,000	2,429,200
DRESDNER BANK AG			
10.95%, 1/30/79	2,000,000	2,000,251	2,000,160
FIRST CITY NATIONAL BANK OF HOUSTON, LONDON BRANCH			
10¼%, 1/25/79	5,000,000	5,000,249	4,995,800
8¾%, 2/22/79	5,000,000	5,000,000	4,974,200
FIRST NATIONAL BANK IN DALLAS, LONDON BRANCH			
11.05%, 2/13/79	3,000,000	3,000,000	3,000,810
11.65%, 2/27/79	3,000,000	3,000,000	3,001,470
HARRIS TRUST AND SAVINGS BANK			
10.30%, 1/19/79	2,000,000	2,000,000	2,000,000
HARRIS TRUST AND SAVINGS BANK, LONDON BRANCH			
11⅜%, 2/20/79	$ 4,000,000	$ 4,000,000	$ 3,996,880
9.71%, 3/28/79	3,000,000	3,000,288	2,985,540
MANUFACTURERS HANOVER TRUST COMPANY			
10¼%, 1/22/79	4,000,000	4,000,000	3,999,480
MANUFACTURERS HANOVER TRUST COMPANY, LONDON BRANCH			
8.85%, 1/15/79	5,000,000	5,000,476	4,993,800
MELLON BANK, N.A., LONDON BRANCH			
11%, 1/8/79	5,000,000	5,000,000	5,000,000
11⅛%, 1/15/79	4,000,000	4,000,000	3,999,600
9.18%, 3/19/79	3,000,000	3,000,435	2,983,440
THE MITSUBISHI BANK, LTD.			
9.57%, 7/7/80, 90-Day Variable Rate	2,000,000	2,000,000	1,998,900
MORGAN GUARANTY TRUST COMPANY, LONDON BRANCH			
9⅜%, 9/8/80	1,000,000	1,064,000	969,130
NATIONAL BANK OF DETROIT, LONDON BRANCH			
8.90%, 1/15/79	5,000,000	5,000,968	4,993,750
THE NORTHERN TRUST COMPANY, LONDON BRANCH			
9%, 3/5/79	5,000,000	5,000,000	4,975,950
RAINIER NATIONAL BANK, LONDON BRANCH			
9.10%, 1/4/79	5,000,000	5,000,000	4,998,250
9.05%, 1/18/79	5,000,000	5,000,000	4,993,050
REPUBLIC NATIONAL BANK OF DALLAS, LONDON BRANCH			
11.10%, 1/8/79	3,000,000	3,000,000	3,000,000
11⅝%, 2/27/79	5,000,000	5,000,000	5,002,200
9%, 2/28/79	1,500,000	1,500,000	1,493,295

Certificates of Deposit (Cont'd)	Rating (Standard & Poor's)	Principal Amount	Average Cost	Value (Note 1-A)
SEATTLE-FIRST NATIONAL BANK, LONDON BRANCH				
9.10%, 2/14/79		4,000,000	4,000,819	3,990,160
9%, 3/5/79		5,000,000	5,000,000	4,975,700
9.77%, 3/8/79		5,000,000	5,000,289	4,982,600
THE SUMITOMO BANK, LIMITED				
10.95%, 1/22/79		5,000,000	5,000,000	4,999,550
11.05%, 1/30/79		2,000,000	2,000,367	2,000,220
11½%, 2/7/79		5,000,000	5,000,000	5,001,350
SWISS BANK CORPORATION				
9.55%, 3/9/79		3,000,000	3,000,000	2,986,920
9.40%, 3/21/79		2,000,000	2,000,000	1,988,700
TEXAS COMMERCE BANK NATIONAL ASSOCIATION, LONDON BRANCH				
11.20%, 2/21/79		3,000,000	3,000,000	2,997,120
UNION BANK OF SWITZERLAND				
11.20%, 2/1/79		5,000,000	5,000,000	4,999,750
9½%, 3/28/79		3,000,000	3,000,000	2,982,480
WELLS FARGO BANK, N.A.				
8.90%, 1/2/79		$ 2,000,000	$ 2,000,000	$ 1,999,680
10%, 1/29/79		2,000,000	2,000,000	1,998,700
10.70%, 2/13/79		5,000,000	5,000,000	5,001,600
10.07%, 4/23/79		5,000,000	5,000,000	4,979,350
			$185,070,010	$184,635,125
Corporate Notes—6.5%				
CHESEBROUGH-POND'S INC. 10.40%, 1/29/79	P1*	$ 2,500,000	$ 2,477,611	$ 2,477,600
CROWN CORK & SEAL COMPANY, INC. 10.15%, 1/15/79	P1*	3,000,000	2,972,933	2,972,940
FIRST CHARTER FINANCIAL CORPORATION				
10%, 1/8/79	A1	1,000,000	991,111	991,110
10.45%, 1/25/79	A1	5,000,000	4,960,813	4,960,800
10.45%, 1/26/79	A1	1,000,000	991,872	991,870
GENERAL MOTORS ACCEPTANCE CORPORATION 9⅞%, 1/3/79	A1	483,000	483,000	483,000
GENERAL TELEPHONE COMPANY OF THE SOUTHEAST 10.20%, 2/5/79	A2	3,500,000	3,440,500	3,440,500
UTILITY FUELS, INC. 10⅛%, 1/10/79	A1	2,000,000	1.983.125	1,983,120
			$ 18,300,965	$ 18,300,940
TOTAL FEDERAL AGENCIES, BANKERS' ACCEPTANCES, CERTIFICATES OF DEPOSIT & CORPORATE NOTES—77.6%			$219,367,490	$218,605,895
CORPORATE BONDS—10.5%				
Electric Utilities—1.5%				
FLORIDA POWER & LIGHT COMPANY Notes, 10¾%, 11/15/81	BBB+	$ 1,000,000	$ 1,041,677	$ 1,007,500
POTOMAC ELECTRIC POWER COMPANY				
1st Mtg., 10¼%, 8/15/81	A+	1,250,000	1,244,375	1,242,187
1st Mtg., 10¾%, 8/15/04	A+	500,000	500,000	528,750
ROCHESTER GAS AND ELECTRIC CORPORATION 1st Mtg., Series AA, 10¾%, 8/1/83	A	1,384,000	1,400,311	1,406,490
			$ 4,186,363	$ 4,184,927
Finance & Credit—0.3%				
PULLMAN LEASING COMPANY Equipment Trust Certificates, Series 1, 10%, 6/15/85	A	$ 1,016,000	$ 1,052,094	$ 1,014,730
Gas & Gas Transmission—1.6%				
ARKANSAS LOUISIANA GAS COMPANY 1st Mtg., 10½%, 9/1/95	AA–	$ 2,450,000	$ 2,633,875	$ 2,526,563
PIONEER CORPORATION Deb., 9½%, 12/15/82	A	2,009,000	2,038,315	1,973,842
			$ 4,672,190	$ 4,500,405
Industrial—1.9%				
UNITED TECHNOLOGIES CORPORATION S.F. Deb., 9⅞%, 4/15/00	AA	$ 5,050,000	$ 5,331,625	$ 5,270,938
Petroleum—1.8%				
BP NORTH AMERICAN FINANCE CORPORATION Guaranteed Deb., 10%, 8/15/00	AA	$ 5,000,000	$ 5,263,695	$ 5,137,500
Transportation—3.4%				
BRANIFF AIRWAYS INCORPORATED Senior Notes, 10%, 7/1/86	BBB–	$ 9,550,000	$ 9,939,188	$ 9,585,813
TOTAL CORPORATE BONDS—10.5%			$ 30,445,155	$ 29,694,313

	Rating (Standard & Poor's)	Principal Amount	Average Cost	Value (Note 1-A)
CANADIAN[1]—4.5%				
BRITISH COLUMBIA HYDRO AND POWER AUTHORITY				
Bonds, Series DN, 10¼%, 10/1/99	AA	$ 1,850,000	$ 1,997,188	$ 1,910,125
MONTREAL URBAN COMMUNITY				
S.F. Deb., 10⅞%, 10/1/00	A	3,356,000	3,480,172	3,481,850
NEW BRUNSWICK ELECTRIC POWER COMMISSION				
Deb., 10½%, 10/1/95	A+	1,500,000	1,599,955	1,548,750
Deb., 10%, 1/15/05	A+	2,100,000	2,121,000	2,097,375
NOVA SCOTIA POWER CORPORATION				
S.F. Deb., 10½%, 9/15/00	A+	2,900,000	3,217,750	2,990,625
PROVINCE OF ONTARIO				
Deb., 10¼%, 10/1/04	AAA	500,000	500,000	521,250
			$ 12,916,065	$ 12,549,975
FOREIGN[2]—3.8%				
CAISSE NATIONALE DES TELECOMMUNICATIONS				
Guaranteed External Notes, 9⅛%, 3/15/80	AAA	$ 4,500,000	$ 4,638,781	$ 4,393,125
EUROPEAN COAL AND STEEL COMMUNITY				
Notes, 8⅞%, 12/15/80	AAA	3,000,000	3,107,282	2,921,250
REPUBLIC OF VENEZUELA				
Notes, 7⅞%, 6/15/82	AAA	2,500,000	2,507,843	2,315,625
SOCIETE NATIONALE DES CHEMINS DE FER FRANCAIS				
Guaranteed Notes, 9⅛%, 4/15/80	AAA	1,100,000	1,127,063	1,073,875
			$ 11,380,969	$ 10,703,875

	Rating (Standard & Poor's)	Shares	Average Cost	Value (Note 1-A)
PREFERRED STOCK—0.8%				
Electric Utilities—0.5%				
FLORIDA POWER & LIGHT COMPANY				
10.08% Cumulative, Series J	A+	12,500	$ 1,268,750	$ 1,362,500
Gas and Gas Transmission—0.3%				
MONTANA-DAKOTA UTILITIES CO.				
11% Series, Cumulative	BBB	9,020	$ 922,734	$ 992,200
TOTAL PREFERRED STOCK—0.8%			$ 2,191,484	$ 2,354,700
PREFERENCE STOCK—0.8%				
Electric Utilities—0.8%				
IOWA-ILLINOIS GAS AND ELECTRIC COMPANY				
$10.75 Series, Cumulative	A	15,000	$ 1,460,671	$ 1,648,125
PENNSYLVANIA POWER & LIGHT COMPANY				
$11.00 Series, Cumulative	BBB	5,000	500,000	545,625
			$ 1,960,671	$ 2,193,750
TOTAL INVESTMENTS		98.0%	$278,261,834‡	$276,102,508
OTHER ASSETS LESS LIABILITIES		2.0%	$ 5,662,064	$ 5,662,064
NET ASSETS		**100.0%**	**$283,923,898**	**$281,764,572**

* Moody's Investors Service, Inc.
‡ The total aggregate cost for Federal tax purposes is $278,284,893.
[1] This category includes marketable securities (payable in U.S. dollars) issued or guaranteed by the Government of Canada, any Province of Canada, or any instrumentality or political subdivision thereof.
[2] This category includes marketable securities (payable in U.S. dollars) issued or guaranteed by a foreign government or community.

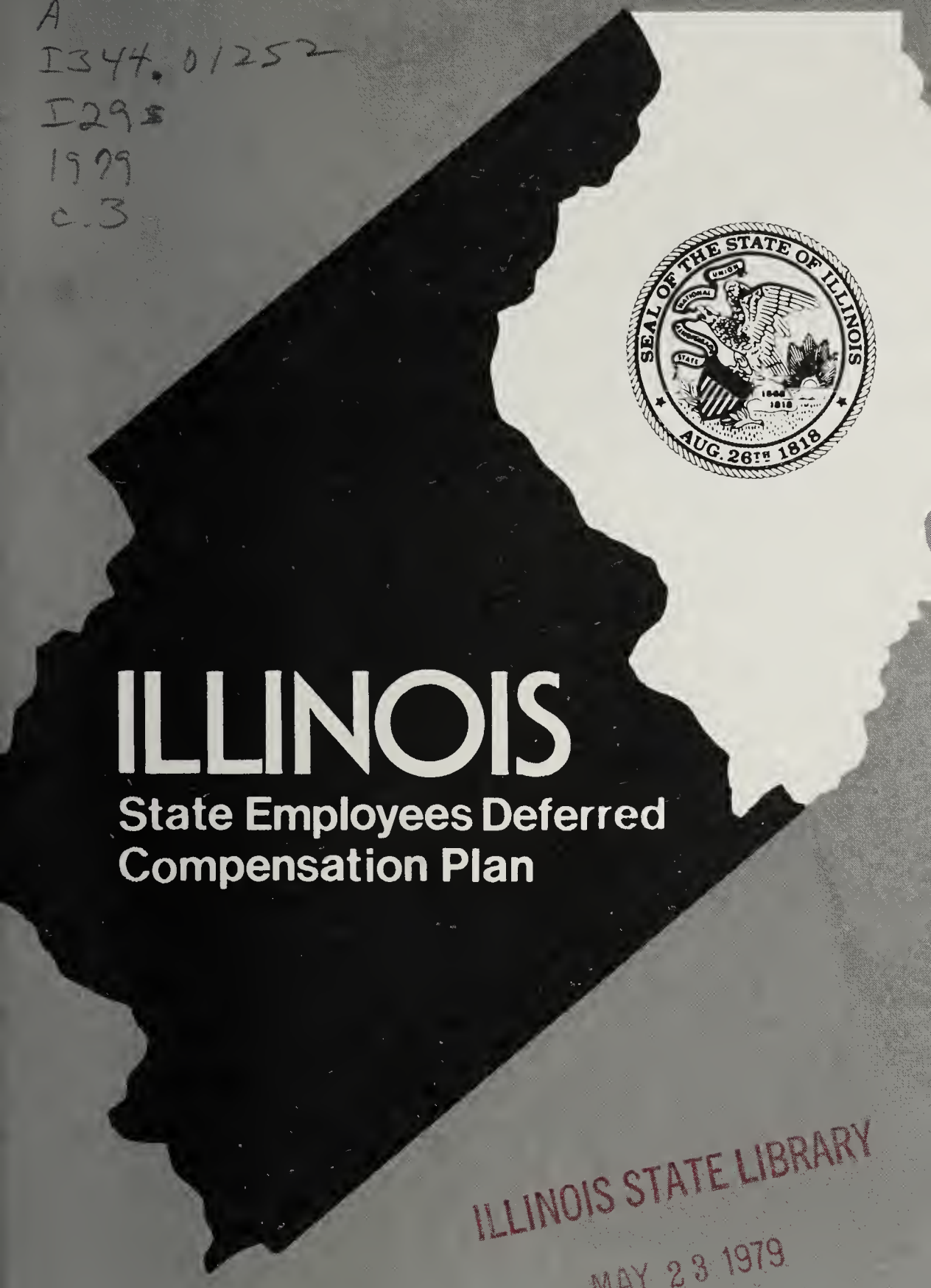
Information in this report should not be considered a representation of the yield that may at any time be realized from an investment in the Fund. The rate of return to shareholders is based upon the dividends paid during the period indicated and is not a representation of future results. The rates of return realized by the Fund should not be mistaken for shareholders' return which takes into consideration the expenses of the Fund.

Because of the many factors which influence fixed income securities, including economic trends, Federal and state actions and regulations, and international monetary conditions, there can be no assurance that the Fund will achieve its objectives.

T. Rowe Price Associates, Inc., Quality Ratings are based on credit analyses which take into consideration such factors as liquidity, profitability, internal generation of funds, and capital adequacy.

This report is authorized for distribution only to shareholders and to others who have received a copy of the prospectus of Rowe Price New Income Fund, Inc.

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State Employees Deferred Compensation Plan

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STATE OF ILLINOIS

OFFICE OF THE GOVERNOR

SPRINGFIELD 62706

JAMES R. THOMPSON
GOVERNOR

To State of Illinois Employees:

The State of Illinois is pleased to offer a Deferred Compensation Plan to all employees. By sponsoring this Plan, the State gives you the opportunity to defer all State and federal income taxes on part of your salary and have any investment earnings on the amount compound free of current taxes.

If you can afford to save now for your future, I think you will welcome this Plan as a convenient and economical method to provide financial security. This type of program has been very popular in many other states and municipalities, and as a result of considerable work and planning, the State of Illinois Plan should be one of the most attractive available anywhere.

This booklet describes how the Plan works and should give you the information you need to decide if it is appropriate for you. The choice of whether to participate is yours. My concern is only that you are fully aware of this opportunity and encourage you to review the information carefully since it should be a very attractive benefit for many State of Illinois employees.

Sincerely,

James R. Thompson
Governor

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HIGHLIGHTS OF THE DEFERRED COMPENSATION PLAN

What is deferred compensation?

It is a unique way for employees to invest before tax dollars by voluntary salary deferral until retirement or earlier termination, death, disability, or hardship, and to have any investment earnings compound free of current taxes. In short, it is a way for State employees to have part of their income taxes they would otherwise pay now go on working for them.

How is this tax benefit possible?

This type of plan has been in use for many years in the private sector but, since 1972, deferred compensation plans have been developed on a broad scale for state and municipal employees throughout the country. The Illinois State Employees' Plan has been approved by the U.S. Internal Revenue Service and the Illinois Department of Revenue. (Copies of these letters are on pages 29-31.)

Who is responsible for the program?

The Department of Personnel is responsible for the ongoing administration of the program. The State Board of Investment established the plan, selected the investment vehicles, and will oversee the administration of the program.

What are my investment choices?

At the present time, the State is offering two choices:

Travelers Guaranteed Interest Group Annuity Contract (Fund A)

Rowe Price New Income Fund, a no-load bond fund (Fund B)

Full descriptions can be found on pages 11-14 in this brochure.

Are there any costs to participate?

Yes. The legislation authorizing the Plan requires that the administrative (and initial development) costs of the Plan be paid out of money deferred.

To cover the State costs a charge of $1 per month will be made to each participant's account plus an annual cost of .2 of 1 percent of the value of each account will be deducted. The fees are based on fairly conservative projections of participation, and it is quite possible that the costs will be reduced after the first year of operation. However, the current costs are among the very lowest of any State Plan available in the county.

Other expenses in conjunction with the Plan such as those for record keeping and promotional activities are borne by the investment funds. Each of the investment funds also has operating expenses. Because the nature of each of the investment funds is different, so are the ways in which they handle their own operating expenses as well as those plan expenses which they bear. These expenses and the methods of handling them are more fully explained in the Investment Funds section.

DEFERRED COMPENSATION-ONE ANSWER TO TAXES AND INFLATION

Most people do not have much in the way of long-term savings which will be of any significant help as a retirement supplement. Because of inflation, you will probably need to supplement your basic pension and Social Security, but it is difficult to get started on a long-term commitment and to stick with it. Even if you do, taxes take anywhere from 20 cents to 50 cents of your top salary dollars making it difficult to save and accumulate a meaningful amount. The Deferred Compensation Plan can help you overcome both inflation and taxes; in recognition of this, the State of Illinois developed its program.

Until a few years ago, the only public employees who had the benefit of a supplemental, tax sheltered program were school teachers. In the early 1970's, legal principles which had been used in the private sector for many years were applied to public employees to create the first government deferred compensation plan by a special tax ruling. The State of Illinois developed a plan following the same principles, and the Plan has been approved by the United States Internal Revenue Service and the Illinois Department of Revenue.

Effective this year, the Internal Revenue Code was amended to add a new section (Section 457) which incorporates the principles applicable to deferred compensation for State employees. This new Code Section will allow additional flexibility in the operation of the program, and the State of Illinois Plan is being amended to take advantage of it. Reference will be made throughout the brochure to some of the changes which are expected.

The Deferred Compensation Plan is fairly simple. You can ask the State to defer part of your salary and, because you haven't legally received it, avoid any State or Federal income taxes on the amount. At the same time, you request the State to invest the deferral in one or both investment options, and earnings credited to your account accumulate and compound tax deferred. The Deferred Compensation Plan, like any tax sheltered program, must operate according to certain rules because it is meant basically for retirement and some of the rules restrict the amount of flexibility you have in the program and your access to the money. For that reason, you are urged to read this brochure carefully before making a decision. Deferred compensation is not appropriate for everyone. Where it is appropriate, however, it can be one of the most effective ways for a State employee to set aside money for a more comfortable retirement.

THE VALUE OF DEFERRED COMPENSATION

The best way to show the value of the Deferred Compensation Plan's tax benefits is to show how much more you can accumulate by saving the same amount of gross income each month for a number of years. In a nutshell, you can: (1) defer taxes in some of your salary now, (2) put more money to work for yourself each month, and (3) have the advantage of taxes being deferred on investment earnings. Illustrations of how it could work for someone in a 20 percent top tax bracket (approximately $11,000 taxable income) and someone in a 35 percent top tax bracket (approximately $25,000 taxable income) are dramatic.

In attempting to save $100 each month, most people have to face a tax bite before they can invest. In a 20 percent tax bracket, only $80 would be left, and in a 35 percent bracket, only $65. Under a deferred compensation plan every penny goes to work.

Additionally, in a regular savings program, current taxes continuously eat away at investment earnings. But, in deferred compensation, earnings compound free of current taxes. Over 20 years, the end result is that deferred compensation could give the individual in the 20 percent bracket $18,410 more and the one in the 35 percent bracket $25,340 more!

	Regular Savings at 20% Bracket	Regular Savings at 35% Bracket	Tax Sheltered Deferred Compensation
Amount Saved Each Month	$ 100	100	$ 100
Less Income Taxes	-$ 20	-$ 35	None
Left for Investment	$ 80	$ 65	$ 100
After 10 Years Amount Invested	$ 9,600	$ 7,800	$ 12,000
Earnings Compounded Monthly at 7.5%	$ 4,634	$ 4,091	$ 5,793
Less Tax on Earnings	-$ 1,124	-$ 1,239	$ None
Total Value	$13,110	$10,652	$ 17,793
After 20 Years Amount Invested	$19,200	$15,600	$ 24,000
Earnings Compounded Monthly at 7.5%	$25,098	$20,392	$ 31,373
Less Tax on Earnings	-$ 7,335	-$ 5,960	None
Total Value	$36,963	$30,032	$ 55,373
	$18,410 less than Deferred Compensation	$25,340 less than Deferred Compensation	

Naturally, you will have to pay taxes when the money is distributed to you, but it will usually be at retirement when your tax bracket is likely to be lower. However, in many cases, the advantage of keeping your money working for you over the years, instead of immediately going to taxes, makes it possible to be in the same or an even higher tax bracket when you take the money out and still be better off with deferred compensation.

* * * *

Another way to look at the tax benefits is as an opportunity to save a certain amount each month and increase your spendable income. Two employees--one earning $15,000 and one earning $25,000 each want to save $100 a month. The table below shows what the impact on spendable income would be--plus the earnings on deferred compensation investments can compound tax deferred.

$15,000 (21% top tax bracket)

	Deferred Compensation	Regular Savings
Monthly Salary	$1,250.00	$1,250.00
Deferred Compensation	- 100.00	--
Taxable Income	1,150.00	1,250.00
Less Taxes	- 150.25	- 171.25
Net	999.75	1,078.75
Less Regular Savings	--	- 100.00
Net	$ 999.75	$ 978.75

$21 More Per Month Spendable Income with Deferred Compensation

$25,000 (32% top tax bracket)

Monthly Salary	$2,150.00	$2,150.00
Deferred Compensation	- 100.00	--
Taxable Income	2,050.00	2,150.00
Less Taxes	- 375.42	- 407.42
Net	1,674.58	1,742.58
Less Regular Savings	--	- 100.00
Net	$1,674.58	$1,642.58

$32 More Per Month Spendable Income with Deferred Compensation

These are, of course, only illustrations and reflect approximate current interest rates and tax brackets. The results cannot be assured but are intended to show the value of the tax benefits available through the Deferred Compensation Plan.

QUESTIONS AND ANSWERS

Eligibility

Who is eligible to participate?

All State employees can participate, whether elected, appointed or salaried, who are receiving compensation while the Plan is effective. The only exception is employees who make up the Committee (appointed by the State Board of Investment) which is responsible for determining whether a participant is entitled to a distribution because of hardship. Persons paid by contractual services are also eligible, but each must obtain a letter ruling from the IRS and Department of Revenue before becoming eligible to participate.

Who should enroll in the Plan?

If you have already established a savings program to meet current needs and would like more income in your retirement years, you will probably benefit from the Plan. If you fall into a category below, you should be particularly interested:

- .Single person with no dependents
- .Members of a dual income family
- .Nearing retirement
- .Paying substantial income taxes

Who should not enroll in the Plan?

Deferred compensation should not be considered:

- .If you simply can't afford to have $50 or more per month withheld from you current spendable income.
- .If you don't have regular savings sufficient to meet your normal needs or emergencies.

Contributions and Investments

Is there a minimum and maximum amount that I can defer?

The minimum employees can defer is $50 per month and amounts above the minimum must be in multiples of $10.00, i.e., $50 or $60 or $70, etc. (not $55, $65). (Plan amendments now under consideration may lower the minimum.)

We would particularly encourage you not to try to defer more than you can comfortably afford and certainly be sure there will be enough left in your pay to accommodate your other voluntary deductions.

The maximum amount deferred during any calendar year cannot exceed 25% of your gross compensation or $7,500, whichever is less. This maximum is imposed under the Revenue Act of 1978 and is expressed in Rule 1 on page 28.

You can defer the applicable maximum over as many or as few months as you wish as long as your salary is sufficient. For example, someone eligible to defer $2400 in a year could either have 12 monthly deferrals of $200 or six monthly deferrals of $400.

The limit will be lower for employees of educational institutions who participate in plans described in Section 403(b) of the Internal Revenue Code (often called the Tax Sheltered Annuity Programs). In this instance, the maximum deferral for deferred compensation is, in effect, reduced by amounts contributed to a 403(b) plan, and you should see your Liaison for more information.

Can I increase or decrease the amount I defer?

Yes. Under the current plan, changes can be made during the annual enrollment period. (Under the revised plan, you will be able to change once every twelve months at any time during the year.)

Can I split the amount deferred between the investment choices?

Yes, you can split your deferral between Fund A and Fund B as long as your percentage split is in multiples of 10%, i.e., 50/50, 60/40, 70/30 and that the total of the two not exceed 100 percent.

How will the deferral affect my pay check?

You need to compute that yourself since it depends on how much you wish to defer and your tax bracket. If you reduce your salary by $100 per month (your deferral) and your deduction for income taxes is 30 percent, you save $100 but your take-home salary will be only reduced by $70.

Equal deferrals will be withheld from your paychecks whether you are paid biweekly, semimonthly, or monthly.

The amount you are deferring will be identified on your pay stub as deduction code "0". The "year to date" gross portion of the pay stub will reflect your full salary without reduction. However, the wages on the W-2 statement you receive each January will have been reduced by the total amount of compensation deferred that calendar year.

Even though your salary isn't reduced on paper until W-2 time, the taxes you pay each pay period are calculated on your salary less Deferred Compensation.

Are my State pension, Social Security, and other benefits affected by Deferred Compensation?

No. Retirement, FICA, and life insurance premiums are calculated on gross pay. Deferred Compensation and/or Tax Sheltered Annuities are then subtracted from gross to give the new basis for federal and state tax calculations.

Will there by any statements to participants?

Yes. A statement reflecting all contributions for the year, earnings and total value of your deferred compensation account will be distributed annually.

What does Section 5.2 of the Plan mean when it states "To the extent that any person acquires a right to receive payments from the State of Illinois under the terms of this Plan, such right shall be no greater than the right of any unsecured general creditor of the State of Illinois" and Section 5.3 which does not require the State to invest deferred funds?

In order to comply with IRS requirements, deferred money must belong to the State. A participant's funds cannot be held in formal or informal trust, but are held in the form of a contractual promise to pay. Consequently, investment requests are not binding. If they were, it would mean the employee controlled the money. Consequently, it was necessary to state that the participant's rights shall be no greater than that of a general creditor.

Changing Your Participation

Am I locked into the program, or can I stop my deferrals?

First of all, you are not locked into any continuing contribution if you change your mind. In other words, you can stop deferrals any time - completely - by filling out the Revocation card provided by the Department of Personnel 45 days prior to the commencement of any pay period. Your first pay period after the 45-day notice will be full salary on a non-deferred basis. (When the plan is revised, you will not be required to give as much advance notice.)

If I stop participating, do I get my money back?

Yes, but not necessarily at that time. Your contributions remain in the Plan to accumulate additional earnings (or losses) until you terminate employment, retire, become disabled, die, or incur a hardship as explained on page 8.

If I discontinue, can I resume at a later date?

If you terminate your program for a temporary reason and later wish to start contributions again, you can do so at the next open enrollment period.

In summary, while you can only get your money out of the program under the specified conditions, you have as an offset considerable flexibility in terms of raising or lowering the amount you contribute and how this money is invested on your behalf.

SOME RESTRICTIONS IN THE PLAN

In order for you to enjoy the substantial tax benefits, and because the program is primarily for retirement, the Internal Revenue Service imposes several restrictions on how the program can operate.

.First of all, you cannot "own and control" the money after it is placed in the Deferred Compensation Plan. There has to be an arms-length distance between you and the money in the Plan. Technically, title to the money deferred belongs to the State of Illinois and you are a general creditor of the State until you qualify for distribution as described below.

.Very importantly, you can get your money out of the program only under five conditions and, therefore, no one should consider this program as anything other than a long-term program. This is not a savings account, and your deferrals should be only money that you have earmarked for your future retirement and not for something else you might have in mind like a house, car, children's education, etc.

The five conditions under which you can get your money out of the program are:

- Retirement
- Termination of your employment with the State
- Becoming fully disabled
- Death (your beneficiary would then receive your benefits as you instructed at enrollment time)
- Incurring extreme financial hardship

The last provision, however, is not for any purpose for which you could logically plan and budget. As explained in the Plan in Section 5.9, you can petition the Committee for distribution of your money, but this would be granted only because of extreme financial hardship such as a severe health situation.

.You have to tell the State now how you want your money paid to you after you stop working. This was a requirement under earlier law to demonstrate that you do not have any continuing control over the money. This election is made on the Enrollment Application form. (However, the new law eliminated this requirement and the revised plan will allow participants to choose the method of distribution just before payments start.)

METHODS OF DISTRIBUTION OF BENEFITS

There are three ways in which your deferred compensation can be paid to you and you must choose at enrollment. You may elect different methods for distribution under each circumstance which will entitle you or your beneficiary to a distribution. For example you might want installments, if you retire, but prefer an annuity for your spouse, if you die.

The methods are:

In a lump sum--In most cases, this will not be desirable since deferred compensation is fully taxable when it is distributed.

In installments--You can have distributions made over a period of up to 15 years on a monthly, quarterly, or annual basis. This not only spreads out the payments so that you won't be taxed heavily in a single year, but also has the advantage that any amounts not distributed will continue to be invested and any earnings will continue to be tax sheltered. If you die before the entire account is distributed, the remainder goes to your beneficiary.

As an annuity--At the time of distribution, an annuity will be established to be paid at annuity rates in effect at the time. In general, an annuity gives you an income for life, but there are various forms of annuities.

A single life annuity is an annuity which is paid as long as you live. When you die, all payments end and nothing is paid to any beneficiaries.

A life annuity with a period certain is similar to a single life annuity but if you die before a certain amount of time - usually 10 or 15 years - payments will continue to your beneficiary until the end of the period.

A survivor annuity is a payment which will continue as long as either you or another named person, e.g. your spouse, lives.

In general, the more factors guaranteed, such as a number of years, the lower the annual income will be. As an illustration, $10,000 would today provide an annual annuity under these various forms for males and females:

	Single Life	Life Plus 10 Year Certain	Life Plus 15 Year Certain	100% Joint and Survivor *
Male 65	$1,209.08	$1,106.03	$1,026.57	$ 958.63
Female 65	$1,061.34	$1,014.60	$ 972.31	

*Male and female each age 65.

These illustrations are based on approximate 1979 rates and do not include all of the forms of annuities which are available. Prior to the time you are entitled to an annuity distribution, a complete sample of forms and rates will be made available to you.

IMPROVEMENTS EXPECTED SOON IN THE DEFERRED COMPENSATION PLAN

The current State Employees Deferred Compensation Plan was written prior to the enactment of the new federal legislation concerning state deferred compensation programs. The major impact of the legislation was to place statutory limits on deferred compensation, but it also allowed deferred compensation plans to be more flexible than was possible in the past. In order to implement a program as soon as possible for State of Illinois employees, the old plan is being used temporarily, but amendments are being considered which would provide as much flexibility as possible in accordance with the new law. The timetable for implementing the new plan depends on the passage of some minor amendments to the Illinois law authorizing Deferred Compensation and the clarification of some points by the Internal Revenue Service. However, it is expected to be available quite soon and all monies deferred under the current plan are expected to be converted to the new rules when they are implemented. While many changes have been mentioned throughout this booklet, we would like to summarize the provisions of the new plan which are expected to be implemented.

Flexibility to Elect the Method of Payments of Benefits

The new plan will allow participants or beneficiaries to select how their deferred compensation funds will be paid to them at the time benefits are to begin rather than being bound by a decision made at the time of enrollment. This change is of major importance since it is difficult to decide years in advance how it will be most appropriate to have your deferred compensation account paid to you.

More Frequent Enrollment and Lower Minimums

Eligible employees will be able to enroll at any time during the year with the request effective in the month following the date of application. Presently, you are only allowed to join during an annual 60-day enrollment period.

Under the new program, the minimum deferral required may be reduced.

More Flexibility to Change the Amount of Deferral

Participants will be able to change the amount of deferral once a year at the time of their choice. The present rules only allow this type of change to be made in November or December.

Changing Investment Choices

Similarly, participants are expected to be able to change their current investment elections at any time during the year. (These changes can be made at a different time than a modification to the amount deferred.) You can change your investment choice once in a twelve-month period.

It is also expected that participants will be able to change the investment of past deferrals as well as future deferrals. The present rules only allow you to change investments in November and the change could only affect future deferrals.

In addition, there have been a number of minor changes which clarify certain plan provisions and streamline the administration and operation of the program.

INVESTMENT FUNDS

Investment Fund A

Contributions made on your behalf which are directed to Investment Fund A will be invested in a Guaranteed Interest Group Annuity Contract with The Travelers Insurance Company of Hartford, Connecticut. The Travelers was selected by the Illinois State Board of Investment over several other financial institutions based on the competitive bids submitted by each company. Founded in 1864, The Travelers is one of the nation's largest multi-line insurance companies offering life, health, and property coverages, as well as financial services. The Travelers first began offering similar contracts in connection with employee retirement or savings plans nearly 50 years ago. The assets of The Travelers are greater than $17 billion, of which nearly $6 billion are held in connection with employee retirement and savings plans. To carry on an operation such as this, The Travelers employs some 30,000 people at several hundred locations across the nation.

The rate of interest guaranteed under the contract issued to the State for 1979 is an effective gross annual rate of 9.25%. After taking into account all expenses allocated specifically to The Travelers Contract as described below, the net return will be at least 8.05%. (Please note that the additional State cost of the program is described separately in this brochure; see page 1 for details.)

Before the end of each year, The Travelers will declare the single interest rate which will be credited during the following year, both with respect to funds already held under the contract and to new funds received by The Travelers during that year. The contract also provides a minimum or down side interest rate guarantee for each of the four years following the year for which an interest rate has already been declared by The Travelers. For example, the declared rate for 1979 is 9.25% and the lowest rate that can be declared by The Travelers for each of the subsequent four years is 1980--8.85%, 1981--8.70%, 1982--8.50%, 1983--8.50%.

The fund held by The Travelers under the contract is guaranteed both as to principle and as to gross interest rates credited. Withdrawals will be made for fees and expenses charged to the contract by The Travelers for investment management as well as for portions of the costs of record keeping and promotions which are allocated to the contract fund. The Travelers' share of record keeping and promotional costs of the Deferred Compensation Plan as determined by the State is limited to .7 of one percent and is expected to be somewhat lower as the Plan grows in size.

The fees of The Travelers for its investment services will be charged quarterly in arrears and will be based upon an annual fee schedule which is applied against Fund A. In terms of dollars, the amounts charged by The Travelers will increase as the fund increases, but in terms of percentages, will decrease as the fund increases beyond particular levels. The initial fee schedule, which cannot be increased by the Travelers before 1980, is as follows: one-half of one percent of the first $2 million of the fund held under the Group Annuity Contract; one-quarter of one percent of the next $8 million; one-tenth of one percent of the next $15 million; and one-twentieth of one percent of any part of the fund above $25 million. So, for example, if the fund's size for a full year were exactly $10 million, the fee charged by The Travelers would be .3 of one percent which would result in a net rate of not less than 8.25% after all expenses.

Investment Fund B

The Illinois State Board of Investment has selected the Rowe Price New Income Fund as the corporate and Government bond vehicle. The Fund's investment advisor, the T. Rowe Price Associates, Inc., was founded in 1937 as a private investment management firm and continues to serve in this capacity today for major municipal and corporate retirement plans, endowments, individuals, and investment companies who have placed over $6 billion under the Price organization's care. T. Rowe Price is one of the largest no-load (no sales commission) fund groups in the country with 250,000 shareholders in all 50 states and some 65 foreign countries. The Price Funds have been included in a number of state and municipal deferred compensation plans, and many of their shareholders are government employees.

The New Income Fund's annual yield based on the latest quarterly dividend was 9%. The Fund paid a $0.2131 dividend on January 11, 1979, to shareholders of record on the opening of business on January 3. If the payment is annualized ($0.2131 x 4 = $0.8524) and divided by the average net asset value per share at the beginning and the end of the dividend period, an annual yield of 9.0% is indicated. Other dividends earned and paid last year were $0.1903 in April, $0.1876 in July, and $0.1932 in October. (All dividends and yield quotations are after all fund expenses.)

A mutual fund is quite simply an investment company which pools money from many investors and invests in various securities on their behalf. In this manner, investors acquire professional investment management and diversification on their investments which would be difficult to do on their own. A no-load fund is one which does not charge any sales commissions. The only costs are management fees and other expenses outlined in the prospectus. These fluctuate slightly from year to year, but were only slightly more than one-half of one percent (.59%) of assets in 1978. (The State cost of the program to you is described separately in this brochure.) Importantly, after these modest expenses, investors receive all earnings of the Fund's investments. You do not have a guaranteed return, but you do not have a limited one either.

The price of the Rowe Price New Income Fund, Inc. is quoted daily in most newspapers under Mutual Funds.

The name Rowe Price New Income Fund indicates a belief that it is possible to obtain a higher return on savings and fixed income monies through new avenues for income investing and through new professionalism in the management of money.

Everyday new opportunities arise which could improve one's fixed-income program, but they usually require a lot of knowledge and money. One of the purposes of the New Income Fund is to help you participate in such opportunities through your Deferred Compensation Plan without having to become an expert or having a lot of capital.

The price of the New Income Fund at the time of its first public offering in October, 1973 was $9.93 per share, and it has fluctuated largely between $9 and $10 ever since. While this can be no promise of the future, Fund management thinks it is a reflection of their being dedicated to reasonable stability of your money, while at the same time seeking higher income for you.

For more complete information about the Rowe Price New Income Fund, including management charges and expenses, please read the enclosed prospectus carefully before you invest or enroll.

HOW TO SIGN UP FOR THE STATE OF ILLINOIS DEFERRED COMPENSATION PLAN

Enrollment Application forms are included in this information package. To enroll, just follow the steps below:

1. Complete and sign all FOUR copies of the Enrollment Application/Beneficiary Election form.

2. Complete and sign all THREE copies of the Deferred Compensation Authorization card.

3. Deliver all SEVEN forms to your LIAISON for proper handling. Later, you will receive a signed and approved copy of the Enrollment Application/Beneficiary Election form for your records.

Enrollment Timetable for Above Forms

1. Eligible employees initially have 60 days from the date the Plan is first opened for enrollment.

2. New employees have 60 days after the date of employment.

3. All employees can enroll during the annual 60-day open enrollment period beginning September 15 and ending November 15 of each year.

IF YOU NEED HELP

If after reading this brochure you have additional questions about the Plan, please see your liaison and/or call:

George Anne Daly - Department of Personnel - 217/782-7006

Questions regarding the specific investment vehicles should be directed to:

Rowe Price New Income Fund - Marketing Department - 1-800-638-1527 toll free

Travelers Guaranteed Interest Group Annuity Contract - George Anne Daly - Department of Personnel - 217/782-7006

If you feel you need financial advice, please see your accountant, attorney, or other professional.

THE STATE (OF ILLINOIS) EMPLOYEES'
DEFERRED COMPENSATION PLAN

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THE STATE EMPLOYEES' DEFERRED COMPENSATION PLAN

Section 1. Introduction and Purpose of Plan

1.1 Establishment of Plan. This Plan shall be known as the "STATE EMPLOYEES' DEFERRED COMPENSATION PLAN" (hereinafter referred to as the "Plan") and is created in accordance with Ch. 108½ 22A-111.1 and 24-104 Ill. Rev. Stat. (1975). The Plan shall be approved and adopted by the Illinois State Board of Investment and shall become effective on the date chosen by the Board following Internal Revenue Service and Illinois Department of Revenue approval.

1.2 Purpose of Plan. The purpose of this Plan is to provide an optional benefit to Employees whereby a designated amount of the Participant's Compensation is withheld each month by the State of Illinois and invested at the discretion of and in a manner approved by the Board until one of the specified events occur which permits all or part of the monies withheld together with earnings, if any, to be payable to the Participant or his Beneficiary. Any monies deferred by Participants may be invested by the Board but there is no requirement for the Board or the State of Illinois to do so. Participation in this Plan shall not be construed as establishing or creating an employment contract between the Participant and the State of Illinois.

Section 2. Definitions

2.1 Definitions. Whenever used in the Plan, the following terms shall have the respective meanings as set forth below unless otherwise expressly provided herein, and when the defined meaning is intended the term is capitalized:

(a) "Accounting Date" means the last day of each calendar month.

(b) "Beneficiary" means the person, persons or legal entity provided for by the Participant to receive any undistributed Deferred Compensation which becomes payable in the event of the Participant's death.

(c) "Board" means the Illinois State Board of Investment.

(d) "Committee" means the Committee established by Board in accordance with Section 4.4 hereof.

(e) "Compensation" means any remuneration payable to an Employee for employment or contractual services rendered by the Employee to the Employer.

(f) "Deferred Compensation" means that portion of the Participant's Compensation which the Participant and Employer mutually agree to defer until the conditions set forth in Section 5 hereof are met.

(g) "Department" means the Department of Personnel of the State of Illinois.

(h) "Disability" means an actual and continuous physical or mental incapacity which causes the Participant to be unable to perform his occupation or employment for wage or profit as determined by the Committee on the basis of medical evidence satisfactory to the Committee and provided that the incapacity results in a termination of the Participants employment or contractual services with the Employer.

(i) "Employee" means any person, including a person elected, appointed or salaried, providing personal services to the Employer. For this purpose, any person under contract with the Employer shall be eligible only to the extent the Internal Revenue Service and the Illinois Department of Revenue permit or approve.

(j) "Employer" means the State of Illinois and its various Departments, Agencies, Commissions and Boards.

(k) "Participant" means any Employee who fulfills the eligibility and enrollment requirements for participation in this Plan as set forth in Section 3 hereof.

(l) "Plan" means the Illinois State Employees' Deferred Compensation Plan as set forth herein and as it may be amended from time to time.

(m) "Retirement" means termination of the Participant's employment or contractual services with the Employer for any reason, other than death, whereby the Participant is eligible to commence receiving benefits from an Employer administered retirement system.

(n) "Termination of Service" means the severance of the Participant's employment relationship or contractual services with the Employer prior to his Retirement, death or Disability.

2.2 Gender and Number. Except when otherwise indicated by the context, any masculine terminology herein shall also include the feminine and neuter, and the definition of any terms herein in the singular may also include the plural.

Section 3. Participation In The Plan

3.1 Eligibility. All Employees of the Employer who are receiving Compensation as of the date the Plan becomes effective shall be eligible to become a Participant in accordance with Section 3.2 hereof, except Employees who are members of the Committee.

3.2 Enrollment. Any Employee eligible to participate in accordance with Section 3.1 above, may become a Participant by agreeing in writing, on a form to be provided by the Department, to a deferment of his Compensation in accordance with Sections 3.3 and 3.4 below on the following basis:

(a) Such Employee may become a Participant commencing with the date the Plan first becomes effective by electing to defer a portion of his prospective Compensation for the balance of the year in which the Plan becomes effective providing his election to do so is made within sixty (60) days after the announcement that the Plan is open for enrollment.

(b) A new Employee who becomes such after the announcement that the Plan is open for enrollment may become a Participant by electing to defer a portion of his prospective Compensation for the balance of the year in which he became a new Employee providing his election to do so is made within sixty (60) days after the date he first became an Employee.

(c) Any other Employee (including an Employee who has revoked his continued participation in the Plan) may become a Participant by electing to defer, by no later than November 15, a portion of his prospective Compensation for the following year.

3.3 Minimum Deferment. Each Employee who becomes a Participant in accordance with Section 3.2 above must agree to defer a minimum of fifty dollars ($50.00) per month and if amounts in excess of the minimum are deferred such amounts will be in multiples of ten dollars ($10.00).

3.4 Maximum Deferment. In no event shall the total of the amount of Deferred Compensation during any calendar year and the employee's nondeferred Compensation for that year exceed the total annual salary or compensation under the existing salary schedule, classification plan or contract applicable to such Employee in that year. Deductions from an Employee's gross Compensation for FICA, taxes, pension contributions and other mandatory or elective deductions shall be made before the Employee's Deferred Compensation is deducted.

3.5 Modifications To Amount Deferred. For Employees who enroll under Section 3.2 hereof and who become Participants, the Employer shall reduce the Participant's total annual Compensation, on a pay period basis, by the Deferred Compensation amount indicated on the Participant's election to defer. That amount, which is subject to Sections 3.3 and 3.4 hereof, may be increased or decreased only by proper application to the Department, which change shall take effect the first pay period of the subsequent calendar year following the date of application and the application shall be made in accordance with the rules set forth in Section 3.2(c) above.

3.6 Revocation of Participation. Any Participant may revoke his election to have Compensation deferred by so notifying the Department in writing 45 days prior to the commencement of any pay period. The Participant's full Compensation on a non-deferred basis will thereupon be restored beginning with the first pay period immediately following the required 45 days notice; however, the Participant's Deferred Compensation shall be paid only as provided for in Section 5 of this Plan.

3.7 Duration of Election to Defer Compensation. Once an election to have Compensation deferred has been made by the Participant, the election shall continue in effect until the Participant's Termination of Service, Retirement, Disability or death, unless prior to such event the Participant revokes his election to defer Compensation in accordance with Section 3.6 hereof.

Section 4. Administration

4.1 Responsibility for Administration. This Plan shall be administered by the Illinois Department of Personnel (the "Department") subject to the general supervision of the Illinois State Board of Investment (the "Board"). Such general supervision shall consist of but not be limited to: Establishment of the Plan, approving or disapproving any proposed changes in the Plan; obtaining Internal Revenue Service and Illinois Department of Revenue approval for the Plan or any amendments thereto if necessary, and reviewing any and all proposed investment offerings, each of which must be determined acceptable by the Board prior to being utilized for the investment of deferred compensation funds.

4.2 Authority of the Department. Subject to the general supervision in Section 4.1, the Department shall have the full power and authority to promulgate, adopt, amend or revoke such rules and regulations as are consistent with this Plan and which are necessary to implement and maintain this Plan.

The Department shall have the authority to require such supportive information, documents or evidence as it deems necessary in order for the Committee to approve withdrawal of any Participant's Deferred Compensation in accordance with the Plan.

Each time that a Participant's Compensation is reduced because of his election to defer, he shall receive a memorandum stating the amount by which his Compensation for the period involved is reduced by reason of such election to defer, and a notation that such amount shall not be included as a part of his Compensation as to that period with respect to taxable income.

The Department, on behalf of the State of Illinois, shall enter into a written agreement with each Participant, which shall set forth the obligations contained in this Plan, the method of payout upon the happening of events specified in the Plan, the amounts of Compensation to be deferred, the name of any Beneficiary(ies), and such other information as the Department deems necessary to administer the Plan.

4.3 Further Duties of the Board. Following approval by the Board of one or more types of investments, if any, to be offered to Participants, the Board shall prepare specifications and submit same to known administrators or providers of that type of investment. The Board shall retain the authority to reject any or all bids as to a particular investment and the Board shall also have the authority to accept more than one bid.

Pamphlets describing this Plan and outlining the options and opportunities available to Participants shall be prepared by the Department, subject to approval of the Board, and distributed to eligible employees upon request or during enrollment periods.

4.4 Establishment of Committee. A Committee shall be formed for the purpose of insuring that the provisions of the Plan are carried out and that the anticipated tax advantages are maintained. This Committee shall be responsible for a determination as to whether a Participant has suffered a Disability. Membership composition of this Committee shall be at the discretion of the Board but shall include at least one Board member or Board Staff member, one Department employee and one person not an employee of the Board or Department. Members of this Committee shall not be entitled to continue deferring Compensation; however, if a member of the Committee was a Participant prior to becoming a member of the Committee his Deferred Compensation may remain in the Plan until it is otherwise distributed. A member of the Committee shall not be entitled to make any determination with respect to any interest that he may have under the Plan.

4.5 Administrative Costs. It is the intent of this Plan that it shall not be implemented or administered so as to be an expense to the State of Illinois other than for the State's obligation to pay the Deferred Compensation as provided hereunder. In this regard, the Employer and Department shall report to the Board their respective costs so that the Board can enumerate these costs along with the Board's own cost. Included in such costs, but not limited to, shall be the costs of making investments, if any, collecting the Deferred Compensation, providing information to Participants and Employees and other agencies of the State.

Section 5. Participant's Accounts, Investments and Distributions

5.1 Establishment of Account. The State of Illinois shall establish a bookkeeping account for each Participant which account shall be credited as of the date the Participant's Compensation is deferred. Subject to Section 4.5 hereof, the account shall also be credited with any increase or decrease incurred by the State of Illinois if it decides to invest any Deferred Compensation hereunder. The State of Illinois is merely under a contractual obligation to make payments under this Plan in accordance with this Section 5 as payments become due hereunder. Any Participant's Deferred Compensation shall become due hereunder. Any Participant's Deferred Compensation shall not be held in trust and no fiduciary relationship of any kind is created between the Participant, his Beneficiary or any other person, and the State of Illinois or the Board, Department or Committee.

5.2 Unsecured General Creditor. Title to, and beneficial ownership of, any assets, whether in cash or investments which the State of Illinois may earmark to pay or measure any Deferred Compensation hereunder, shall, at all times, remain as a part of the general assets of the State of Illinois. The Participant and his Beneficiary shall not have any property interest whatsoever in any specific asset of the State of Illinois on account of his election to defer any Compensation under this Plan. To the extent that any person acquires a right to receive payments from the State of Illinois under the terms of this Plan, such right shall be no greater than the right of any unsecured general creditor of the State of Illinois.

5.3 Investment Requests. Upon enrollment in the Plan under Section 3.2 hereof, each Participant may request, on a form to be provided for such purpose by the Department, the portion of his Deferred Compensation which could be invested in one or more of the following Investment Funds as may be made available by the Board at its discretion:

(1) Investment Fund A which shall be invested by the Board (in the Board's discretion) in, but not limited to, savings and loan or commercial bank deposits, commercial paper, or guaranteed interest contracts of insurance companies.

(2) Investment Fund B which shall be invested by the Board (in the Board's discretion) in, but not limited to, corporate or Government bonds.

(3) Investment Fund C which shall be invested by the Board in the Board 's discretion, in insurance company contracts (either on a group or individual basis) designed to provide an annuity.

(4) Investment Fund D which shall be invested by the Board (in the Board's discretion) in, but not limited to, common or preferred stocks, similar equity securities or other property expected to offer growth possibilities.

Each Participant may request that his Deferred Compensation account be invested 100% in any of the above Investment Funds or in multiples of 10% thereof in any combination of Investment Funds so long as the total equals 100%. The Participants investment request shall specify the multiples of said Deferred Compensation which may be invested in each of the said Investment Funds. Once made, an investment request shall continue for any deferments in any following calendar year unless changed by the Participant in accordance with the following paragraph.

The Participant's investment request may be changed for his Compensation to be deferred for a following calendar year providing the revised investment request is filed with the Department within at least 45 days prior to the commencement of such following calendar year on a form to be provided by the Department.

With respect to the Investment Funds which may be created by this Plan, the Board is specifically authorized to invest same on behalf of the State of Illinois and to utilize outside investment managers to the extent deemed appropriate by the Board. The Board also has the authority to eliminate any or all of the Investment Funds created by the Plan.

5.4 Mode of Distributions. At the time the Employee becomes eligible to be and actually enrolls in the Plan as a Participant in accordance with Section 3.2 hereof, he shall execute an irrevocable election in writing, on a form to be provided by the Department, as to which of the following payment alternatives shall be applicable to him for the Deferred Compensation payable from his account upon his Retirement or earlier Termination of Service. This irrevocable election may be changed for any prospective Compensation to be deferred under this Plan providing the election is made, on a form to be provided by the Department, by no later than November 15 prior to the calendar year for which the change is to be made.

At the time the Participant makes his irrevocable election hereunder, he shall specify the payment alternative applicable to his Beneficiary in the event he should die prior to receiving the full amount of his account.

(a) In a lump sum, to be distributed within 60 days after such Termination of Service or Retirement occurred; or

(b) In a series of substantially equal installments over a fixed period of time not exceeding fifteen years, with such installments to begin within 60 days following

such Termination of Service or Retirement as is administratively feasible. The amount of the first installment on an annual basis shall be the value in the Participant's account on the Accounting Date on which the installment is payable times a fraction which is one over the total number of installments to be made. The amount of each subsequent installment on an annual basis shall be the remaining value in the Participant's account on the Accounting Date on which the installment is payable times a fraction which is one over the remaining number of installments to be made; or

(c) In a series of payments on an annuity basis with such payments to begin not later than the month following the Participant's actual Retirement or Termination of Service which would be provided if made through the purchase from an insurance company of an annuity contract with ownership of the annuity contract remaining with the State of Illinois and with the the State of Illinois also being the named beneficiary of such contract; or

(d) Any combination of the foregoing.

If a Participant entitled to receive or receiving distribution under this Plan should die prior to the time he has received the full distribution to which he was entitled at the date payments commenced, then the amount to which he is entitled at the date of his death shall be distributed to the deceased Participant's Beneficiary in accordance with the irrevocable election made by the Participant prior to the time the Compensation was deferred.

5.5 Accounting Dates and Investment Fund Valuation. Any Investment Fund under the Plan is to be valued as of each Accounting Date so that a Participant's account can be determined as of any Accounting Date. Any Investment Fund is to be valued by the Board at the fair market value thereof as of each Accounting Date on a reasonable and consistent basis. Any withdrawals or distributions made under this Plan shall be made in cash and may be made from any such Investment Fund only as of the first day of a month. The amount paid upon such withdrawal or distribution shall be based upon the Participant's account as of the Accounting Date specified in Section 5.6, 5.7 or 5.8 hereof.

5.6 Distribution Upon Retirement or Death. Subject to the provisions of Section 5.2 hereof, upon the Retirement or death of a Participant, there shall be distributed to the Participant, or to his Beneficiary in the case of death, in the manner set forth in Section 5.4 hereof, the Participant's account as of the Accounting Date next preceding or coincident with the date of such Retirement (providing that the Participant advised the Department in writing at least 45 days prior to his intended date of retirement, and if he did not so advise the Department, the

Accounting Date used to value his account will be the second Accounting Date next following his date of Retirement) or death, plus any amounts credited to his account by payroll deduction subsequent to such Accounting Date.

5.7 Distribution Upon Termination because of Disability. Subject to the provisions of Section 5.2 hereof, upon the termination of employment of a Participant because of his Disability, there shall be distributed to the Participant in the manner set forth in Section 5.4 hereof, the Participant's account as of the Accounting Date next preceding or coincident with the date of such termination of employment, plus any amounts credited to his account subsequent to such Accounting Date because of payroll deductions.

5.8 Distribution Upon Termination of Service Prior to Retirement for reasons other than Death or Disability. Subject to the provisions of Section 5.2 hereof, upon the Participant's Termination of Service prior to his retirement for any reason other than his death or Disability, there shall be distributed to him the full amount of his account in the Plan as of the Accounting Date next preceding or coincident with the distribution dates selected in Section 5.4 hereof.

5.9 Financial Hardship. A withdrawal of Deferred Compensation credited to a Participant's account shall be permitted in the event the Participant experiences serious financial hardship which is beyond his control and which would cause the Participant severe hardship if such withdrawal were not permitted. Serious financial hardship may include a disability or unexpected and unreimbursed major expenses resulting from illness or accident. Any Participant desiring such withdrawal by reason of serious financial hardship must apply to the Committee and demonstrate that the circumstances being experienced were not under the Participant's control and constitute a real emergency which is likely to cause him great financial hardship. The Committee shall have the authority to require such medical or other evidence as it may need to determine the necessity for Participant's withdrawal request.

If such application for withdrawal is permitted, the amount of such withdrawal shall be limited to an amount sufficient only to meet the emergency and shall in no event exceed the amount of his account as of the Accounting Date next preceding or coincident with such withdrawal.

The allowed amount of withdrawal shall be payable in a lump sum within (90) days of notice to the Participant of approval by the Committee. If a Participant makes a withdrawal the amount of his account under the Plan shall be proportionately reduced to reflect such withdrawal. The balance of his account, if any, shall be payable according to otherwise applicable provisions of the Plan.

5.10 Leave of Absence. Any Participant who is granted a leave of absence by the Employer for up to one year may continue to participate in this Plan. At such time as said approved leave of absence exceeds one year, the Participant shall be treated as having a Termination of Service under this Plan and payment shall be made according to Section 5.4; however, actual payment shall not be made until the Participant has actually terminated employment, retired, or died. The term "leave of absence" as used in this subsection includes a layoff.

5.11 Designation of a Beneficiary. Every Participant shall, upon becoming a Participant, designate, upon such forms as may be provided for that purpose, a beneficiary or beneficiaries who are to receive his Deferred Compensation under the Plan in the event of his death, but the designation of a beneficiary or beneficiaries shall not be effective for any purpose unless and until it has been filed by the Participant with the Department on a form approved by the Department. In the event that a Participant shall not designate a beneficiary or beneficiaries in the manner heretofore stated, or if for any reason such designation shall be legally ineffective, or if said beneficiary or beneficiaries predecease the Participant, then for the purpose of the Plan, payments shall be made to the Participant's estate. A Participant may, from time to time, on a form approved by the Department, change his beneficiary or beneficiaries.

Section 6. Non-Assignability

6.1 Non-Assignability. This Plan and any contract entered into between the Employer and a Participant and the benefits, procedures or payments thereunder are non-assignable and non-transferable and shall not be sold, assigned, pledged, commuted, transferred or otherwise conveyed by any Employer, Participant or Beneficiary. Any attempt to so assign or transfer shall not be recognized and shall impose no liability upon the Employer, and shall be deemed to constitute a revocation by such Participant pursuant to Section 3.6 hereof.

The State of Illinois shall be the owner of all Deferred Compensation hereunder and shall be the sole beneficiary of any investment contract entered into pursuant to this Plan. The Board shall be the custodian of said investment contracts and shall take the steps necessary to provide a place of safekeeping for said contracts.

Except as otherwise required by law, any Deferred Compensation paid pursuant to this Plan shall not be subject to attachment, garnishment, or execution, or to transfer by operation of law in the event of bankruptcy or insolvency.

Section 7. Amendment or Termination of Plan

7.1 Amendment of Plan. The Department shall have the authority to propose amendments to this Plan from time to time by submitting same in writing to the Board for its approval. No amendment or modification shall affect the rights of Participants or their Beneficiaries to the receipt of Compensation deferred prior to such amendment or modification.

7.2 Termination of Plan. The Board shall have the authority to terminate this Plan, or to substitute a new Plan approved by the Internal Revenue Service and the Illinois Department of Revenue. Upon termination each Participant shall be deemed to have withdrawn from the Plan as of the date of such termination; the Participant's full Compensation on a non-deferred basis will be thereupon restored; and the Department shall treat such Participants as if they had a Termination of Service on the date of such termination and pay such Deferred Compensation in accordance with Section 5.4 hereof.

Section 8. Applicable Law

8.1 Applicable Law. This Plan shall be construed, administered and governed in all respects under and by the laws of the State of Illinois

IN WITNESS WHEREOF, the State of Illinois has caused this Plan to be approved and adopted by the Illinois State Board of Investment and signed by its duly authorized officers on this 10th day of September, 1976.

Name

Chairman
Title

Subscribed and sworn to before
me this 10th day of September
1976.

Notary Public

Administrative Rule I

The maximum amount of deferred compensation during any calendar year shall not exceed the lesser of 33 1/3% of includible compensation or $7,500, whichever is less. "Includible compensation" is the participant's compensation less any deferrals made during the year either through this Plan or plan under Section 403(b) of the Internal Revenue Code.

Administrative Rule II

A one-dollar ($1.00) per month participant charge plus an annual asset charge of two-tenths of one percent (.002) will be levied against the account of each employee participating in the State Employees' Deferred Compensation Plan.

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Person to Contact: Peter J. Frederick

Telephone Number: (202) 964-4751

Refer Reply to: T:I:I:3:3

Date: 7 OCT 1976

Robert A. Tingler, Esq.
Special Assistant Attorney General
State of Illinois
11 South La Salle Street
Suite 3100
Chicago, Illinois 60603

RECEIVED
OCT 18 1976
ILLINOIS STATE BOARD OF INVESTMENT

Dear Mr. Tingler:

This is in reply to your letter of September 10, 1976, and prior correspondence, requesting a ruling concering the Federal income tax consequences under section 451 of the Internal Revenue Code of a non-qualified unfunded deferred compensation plan (the "Plan") which the State of Illinois (the "State") proposes to implement for its employees.

With your letter of September 10, 1976, you submitted a copy of the Plan and a copy of the related form entitled "Illinois State Employees' Deferred Compensation Plan Enrollment Application." The facts in your letter of September 10, 1976, and your prior correspondence and the provisions of the two aforementioned documents, as submitted, are incorporated in this letter by reference.

Based solely on the information and documents submitted, it is held that if a participant reports his income using the cash receipts and disbursements method of accounting, amounts payable under the Plan will not be includible in gross income until the taxable year in which such amounts are paid or otherwise made available, whichever is earlier, to the participant, his beneficiary, or his estate.

This ruling is based on the condition that all amounts of compensation deferred under the Plan and any property purchased with such amounts (including life insurance policies, annuity contracts, or any other assets) will at all times remain solely the property of the State subject to the claims of its general creditors, and be available for the State's use for whatever purposes it desires. If the State chooses to invest the deferred amounts, the State must be the sole owner, as well as the beneficiary in the case of insurance or annuity contracts, of all assets purchased.

It should be noted that this ruling applies only to employees of the State. If an independently contracted individual desires a ruling concering his or her participation in the Plan, a separate request must be submitted, following the procedures set forth in the enclosed copy of Rev. Proc. 72-3, 1972-1 C.B. 698. The following information should also be submitted with each such independent contractor's ruling request.

1. A copy of any employment agreement between the State and the independent contractor or, if none, a detailed explanation of their working arrangement including information with respect to how compensation is determined.

2. If the independent contractor is a member of a partnership, a copy of the partnership agreement and a statement as to whether the other partners also perform services for the State, and, if so, whether these partners will also be participating in the Plan. If the independent contractor is not a member of a partnership a statement to that effect should be submitted.

3. A statement as to whether the independent contractor is associated with a professional corporation.

Only if applicable State law permits implementation of the Plan as approved by the Internal Revenue Service will this ruling be effective.

If the Plan is amended or modified, this ruling will not necessarily remain applicable.

Sincerely yours,

Marie E Finnegan

Chief, Individual Income Tax Branch

Enclosure

STATE OF ILLINOIS
DEPARTMENT OF REVENUE

February 18, 1977

RECEIVED
FEB 2[illegible] 1977
ILLINOIS STATE BOARD OF INVESTMENT

Mr. Richard A. LaPointe
Director
Illinois State Board of Investment
Suite 905 - 180 North LaSalle Street
Chicago, Illinois 60601

Re: The State of Illinois Employees' Deferred Compensation Plan

Dear Mr. LaPointe:

I am writing in answer to the letter of Mr. Robert A. Tingler, Special Assistant Attorney General representing the Illinois State Board of Investment dated October 22, 1976, and addressed to former Director Robert H. Allphin.

You are advised that, to the extent the federal income tax consequences are, and continue to be, as described in the Internal Revenue Service ruling letter of October 7, 1976, Illinois income tax consequences will be the same; i.e., for state (Illinois) employees, "amounts payable under the Plan will not be includible in gross income until the taxable year in which such amounts are paid or otherwise made available, whichever is earlier, to the participant, his beneficiary, or his estate". Consequently, for Illinois Income Tax Act purposes, compensation deferred under the Plan will not be subject to income tax in the year in which it is earned; any taxation of such compensation will be deferred until the time of its distribution.

Very truly yours,

George T. Rummel
Associate Director

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ILLINOIS STATE EMPLOYEES' DEFERRED COMPENSATION PLAN
INITIAL ENROLLMENT APPLICATION

(PLEASE PRINT OR TYPE SO THE INFORMATION IS LEGIBLE ON ALL 4 COPIES. SEND ALL 4 COPIES OF THE COMPLETED FORM TO YOUR DEFERRED COMPENSATION LIAISON.)

LAST NAME _____ FIRST _____ MIDDLE INITIAL _____ SOCIAL SECURITY NO. _____

STREET _____ CITY/STATE _____ ZIP _____

AGENCY OR UNIVERSITY _____ LOCATION _____ OFFICE PHONE NO. _____

It is the responsibility of the participant to keep the Department of Personnel notified of any address change.

Election To Participate

I hereby elect to participate in the Illinois State Employees' Deferred Compensation Plan. I authorize the State of Illinois to defer from my total compensation $_____ each pay period, until my retirement, termination, death, disability or revocation.

☐ Bi-weekly ☐ Semi-monthly ☐ Monthly

I understand and acknowledge that all assets under the Plan, whether in cash or investments, shall, at all times, remain as a part of the general assets of the State of Illinois.

(The minimum monthly deferral is $50.00 and amounts in excess of the minimum must be in even multiples of $10.00.)

Investment Request

I hereby request that any amounts of my deferred compensation which are invested by the Illinois State Board of Investment be invested in the following manner (multiples of 10% only). I understand that according to the terms of the Plan the State of Illinois and its agents are not required to invest deferred funds in any manner whatsoever.

_____ % in Investment Fund A, a guaranteed interest contract of The Travelers Insurance Company.

_____ % in Investment Fund B, a no-load bond portfolio offered by the Rowe Price New Income Fund, Inc., for which I have received a current prospectus.

(The above percentages must total 100%)

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MAY 23 1979
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Benefit Payment (This election is irrevocable except for future deferrals.)

(Retirement (A) is defined in the Plan as termination of the participant's employment or contractual services for any reason other than death whereby the participant is eligible to commence receiving benefits from an employer-administered retirement system. Termination (B) means the severance of the participant's employment or contractual services prior to retirement, death or disability. The periodic payments may be made monthly, quarterly, semi-annually or yearly.)

Complete all four.

A. Retirement Benefits
- ☐ Lump sum.
- ☐ Periodic payments made _____, over _____ years (not more than 15.)
- ☐ Annuity for life.

B. Termination Benefits
- ☐ Lump sum - ☐ immediately ☐ at age _____
- ☐ Periodic payments made _____, over _____ years (not more than 15.)
- ☐ Annuity for life.

C. Death Benefits
- ☐ Lump sum to beneficiary.
- ☐ Periodic payments to beneficiary made _____, over _____ years.
- ☐ Annuity to beneficiary for life.

D. Disability Benefits
- ☐ Lump sum - ☐ immediately ☐ at age _____
- ☐ Periodic payments made _____, over _____ years
- ☐ Annuity for life.

Note: Benefits will be paid at whichever event occurs first.

Beneficiary Election

(**Important** - Read the Beneficiary Conditions before completing. If more space is needed, please attach a separate list.)

I hereby elect the following to be my beneficiary(ies):

Primary

Name(s) _____ _____ _____ _____ _____
LAST FIRST MIDDLE INITIAL RELATIONSHIP PERCENT TO RECEIVE

Street _____ City/State _____ Zip _____

Name(s) _____ _____ _____ _____ _____
LAST FIRST MIDDLE INITIAL RELATIONSHIP PERCENT TO RECEIVE

Street _____ City/State _____ Zip _____

Contingent (only effective after the death of any and all primary beneficiaries)

Name(s) _____ _____ _____ _____ _____
LAST FIRST MIDDLE INITIAL RELATIONSHIP PERCENT TO RECEIVE

Street _____ City/State _____ Zip _____

Name(s) _____ _____ _____ _____ _____
LAST FIRST MIDDLE INITIAL RELATIONSHIP PERCENT TO RECEIVE

Street _____ City/State _____ Zip _____

Beneficiary Conditions

Participants may designate primary and contingent beneficiaries. A contingent beneficiary and/or beneficiaries will become effective only after the death of any and all primary beneficiaries.

If more than one beneficiary is named in either category, benefits will be paid according to the following rules:

Beneficiaries can be designated to share equally or to receive specific percentages.

Example 1: Doe, John and Mary - Parents - Equal Shares
Example 2: Doe, John - Father - 30%
Doe, Mary - Mother - 70%

If a beneficiary dies before the participant, the benefits will be paid only to the surviving beneficiaries. If more than two beneficiaries are originally named to receive different percentages of the benefits, surviving beneficiaries will share in the same proportion to each other as indicated in the original designation.

Example: Original designation is: John Doe, 10% and Mary Doe, 50% and William Doe, 40%. If Mary Doe dies before the participant, John Doe would be entitled to receive 20% of the benefits and William Doe, 80%.

If a beneficiary dies before receiving all payments of an installment distribution, the remaining distributions will be paid to the heirs or the estate of the beneficiary.

It is the responsibility of the participant to keep the designation of the beneficiary and the beneficiary's address current.

Signature _____ Date _____
EMPLOYEE

TO BE FILLED IN BY AGENCY OR UNIVERSITY LIAISON

Deferral per pay period _____ Deferral per month _____
Effective pay period _____ Payroll Code No. _____

Disposition of Copies (after approved by the Department)

1. Department of Personnel
2. Record-keeping Agent
3. Agency
4. Employee

Approval of Department of Personnel
(Required before any transaction takes place)

_____ Date _____

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STATE OF ILLINOIS
DEPARTMENT OF PERSONNEL
SPRINGFIELD 62706

WILLIAM J. BOYS
DIRECTOR

DAVID V. HARDWICK
ASSISTANT DIRECTOR

MEMORANDUM

ILLINOIS STATE LIBRARY
MAY 23 1979
ILLINOIS DOCUMENTS

TO: All Employees Who Requested More Information on Deferred Compensation

FROM: William Boys, Director

Thank you for requesting more information on the State of Illinois Employees' Deferred Compensation Plan. We hope that the enclosed material will answer your questions and help you decide whether to join.

The initial 60-day enrollment period officially begins March 29; however, material may be circulated immediately. There will not be another opportunity for current employees to enroll until September 15, 1979 (unless the Plan amendments described in the brochure are implemented before that time).

If, after you have read all the material and decide you want to join, please complete and sign all four copies of the enrollment form and three copies of the payroll authorization card. Deliver all seven of these forms to your Liaison for proper handling.

These forms must be in the hands of your Liaison by April 15 if you want your deferral to start the pay period beginning May 1. If you want the payroll deferral to begin June 1, the forms need to be sent to your Liaison by May 11.

We feel Deferred Compensation is a good program which provides an opportunity for many to make additional retirement savings and defer current taxes. We do ask, however, that you read the material carefully and make your own decision because participation is not appropriate for everyone.

Thank you again for your interest in Deferred Compensation.

cc: Deferred Compensation Liaisons